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GROUNDWORK OF ECONOMICS

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GROUNDWORK OF ECONOMICS

BY

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PREFACE TO THE FIRST EDITION.

THIS book is an attempt to give a concise, clear, and unbiased survey of the whole field of economics. It has been primarily written for those who have not yet made a systematic study of the subject, and for this reason the descriptive and historical sides have been emphasised.

Special attention has been given to the most important economic problems of the day, and among the subjects discussed are: unemployment, industrial fluctuations, changes in price levels, social insurance, industrial peace, the rationalisation of industry, Trade Boards and the minimum wage, Trade Unionism, the Co-operative Movement, instalment buying, international trade, markets and marketing, inflation and deflation, bank amalgamations, central banking, the gold standard, foreign exchange, public revenue and expenditure.

The book has been written for the general reader as well as for the student. The general reader will find it a plain account of the subject-matter of economics; the student will find it useful for examination purposes. Great care has been taken to include the matter required for the Qualifying and Subsidiary Examinations of the Universities, and, among others, the Examinations of the Institute of Bankers, the Institute of Chartered Accountants, and the Institute of Chartered Secretaries.

I am very much indebted to Mr. P. A. Earle, B.Sc. (Econ.) Lond., who read the whole of the book in manuscript. His valuable criticisms and assistance have enabled me to remove

many imperfections. I have also to thank Mr. Reginald A. G. Travers, B.Sc. (Econ.) Lond., for reading the proofs of several chapters and for his helpful criticisms and suggestions.

My obligations to existing works, particularly those of Professor Taussig, Mr. Hartley Withers, and Marshall, are numerous, and have been acknowledged in the footnotes.

R. D. R.

NOTE TO THE THIRD EDITION.

For the second edition, the book was completely revised, enlarged, and brought up to date. A number of useful Appendices were added, and the Bibliography considerably extended. In the third edition, the major part of the work has not been altered, but where necessary changes have been made to bring the work in line with current affairs. This applies particularly to the statistical data.

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CHAPTER I.

INTRODUCTORY: THE SUBSTANCE AND SCOPE OF ECONOMICS.

"The economic is the foundation of all social organisation. For until man is able to supply himself with the means of subsistence, it is idle to expect any development of the higher and more refined sides of civilisation."—Mayo-Smith, *Economics and Statistics*.

Wants, efforts, satisfactions comprise the circle of life's activities, a circle in which we move either successfully or unsuccessfully according to the extent of our self-interest, our interest in others, our education, our experience, our judgment, our ability, our courage, our opportunities. Economics deals with the actual conditions of this circle; it examines our activities in the business of life, not as they ought to be, or as they would be under ideal conditions in a modern Utopia or Arcadia, but as they are—a mixture of meanness and of nobility, of sorrow and of joy.

"Economics," states Sir Sydney Chapman, "treats of all the actions of human beings in relation to wealth."¹ "The subject-matter of political economy or economics," declares Professor Cannan, "has always been the wealth of human beings generally."² "Political economy," explains Jevons, "treats of the wealth of nations; it inquires into the causes which make one nation more rich than another."³

¹ *Outlines of Political Economy* (1925 ed.), p. 1.

² *Wealth* (second ed., 1924), p. 2. ³ *Political Economy* (1878), p. 7.

It is clear from these definitions that we are all, more or less, economists. We are all engaged in the pursuit of wealth—a term which, as we shall see, requires careful examination—either as wage earners or property owners. Indeed, we frequently participate in this pursuit in both of these capacities. But our object is to satisfy our wants with the least effort and sacrifice.

Strictly speaking, therefore, economics is not concerned with the ideal, with the idea of ultimate good, with standards of conduct. This is the field of ethics, the science of morals. The economist is not necessarily a moralist. He is concerned with facts, their sequence and their harmonisation; with cause and effect; with tendencies; with, as Sidgwick puts it, the study of "what is" rather than "what ought to be done."¹

During the nineteenth century, however, many French and English economists frequently emphasised the ethical side in their writings. Chalmers,² for instance, published in 1832 a treatise entitled *On Political Economy in Connection with the Moral State and Moral Prospects of Society*, and in 1860 a French economist named Baudrillart issued his *Relations of Ethics and Political Economy*,³ while Ruskin believed that economics could not be studied apart from ethics, because, as Professor Barker states, "he felt that no beauty of life was possible when wealth became the master, and ceased to be the servant, of life."⁴

There were also during this period, a number of German economic moralists such as Wagner and Schoenberg; the latter

¹ *Principles of Political Economy* (second ed., 1887), p. 18. Henry Sidgwick (1835-1900) was Professor of Moral and Political Philosophy in the University of Cambridge from 1883-1900.

² Dr. Thomas Chalmers (1780-1847), Professor of Moral and Political Economy at St. Andrews (1825-28), and afterwards (1828-43) Professor of Divinity in the University of Edinburgh.

³ *Des Rapports de la Morale et de l'Économie Politique*.

⁴ *Political Thought from Spencer to To-day* (1915), p. 192.

states that the economist should investigate not only how men live but also "how far through their economic activity the moral aims of life are fulfilled."¹ Even quite recently an English economic writer, Sir John Marriott, has given us an interesting treatise entitled *Economics and Ethics*.

On the other hand, there are many economists who consider that ethics and economics should be rigidly kept apart. "The economist, as such," declares Walker,² for example, "has nothing to do with the question whether existing institutions, or laws, or customs, are right or wrong; why right, or how far right; why wrong, or how far wrong. His only concern with them is to ascertain how they do, in fact, affect the production and distribution of wealth."

There is, however, really no reason why the economist should not consider the ideal in examining the real. He can, undoubtedly, as a result of his investigations, arrive at certain conclusions, formulate rules, and lay down precepts by means of which mankind may get nearer to the ideal. In fact, economics, or, as it is often called, political economy, came into existence when certain writers attempted to formulate a number of rules for the help of statesmen, rules which were meant to improve the welfare of mankind.

But, though some economists may be prepared to "wed" economics and ethics, and others to exclude the ethical when studying the economic, there is no doubt that both psychology and history are particularly useful to the economist. Professor Foxwell has stated that economics is "anchored in psychology," in the science of the mind which investigates the laws of consciousness. Psychology deals with the working of the mind, with motives, with will power, with concentration,

¹ Quoted in Boucke, *Development of Economics* (1922), p. 159.

² *Political Economy* (1838), p. 26. Francis Amasa Walker (1840-97) was Professor of Political Economy in the Sheffield Scientific School of Yale College from 1872 to 1888, and President of the Massachusetts Institute of Technology from 1888 to 1897.

with behaviour, all of which are of the greatest importance in the study of economies. "Nature," writes Bentham,¹ "has placed mankind under the governance of two sovereign masters—pain and pleasure. It is for them alone to point out what we ought to do as well as to determine what we shall do." We have only to consider the effects of pain and pleasure upon our wants in order to form some conception of the importance of a knowledge of psychology to the economist.

History helps us to interpret the present with a knowledge of the past. Modern economic problems have their roots in the past; many are centuries old, and the history of their origin and development greatly assists the economist to analyse them. Moreover, the correct study of history needs not only impartiality but also a certain amount of sympathy with ideas which are different from our own, and which are often contrary to one another. "Severed from historical studies," writes Sir Sydney Chapman,² "the science of political economy would be an impossibility."

Statistics and mathematics, also, are of great service to the economist. By means of statistics numerous comparisons can be made in various spheres of economic activity. Thus, for example, statistics appertaining to prices, wages, and the cost of living at different times, and in different countries, enable us to arrive at many conclusions, while export and import figures covering a number of years give us valuable information about the economic condition of a nation. "Figures," observes Mayo-Smith, "are merely a method of expressing facts."³

Mathematics helps to give the subject-matter of economics a greater clearness, and the mathematical treatment of economics has been a feature of the treatises of many economists,

¹ *An Introduction to the Principles of Morals and Legislation* (1823), Vol. I., p. 1. Jeremy Bentham (1748-1832), philosopher and economist, was a distinguished writer and reformer.

² *Outlines of Political Economy*, p. 17.

³ *Economics and Statistics* (1899), Pt. II., p. 9.

particularly those of Jevons, Marshall, and Fisher. "The direct application of mathematical reasoning to the discovery of economic truths," writes Marshall,¹ "has recently rendered great services in the hands of master mathematicians."

Furthermore, economics is sometimes regarded as a branch of the wider science of sociology, the science of society. Hence the older name political economy, which is really equivalent to social economy. But the term political is now applied to governmental action and regulation, and in this connection we speak of political science. Economics, however, is in certain ways connected with politics; it examines the effects of government activity in relation to wealth, while a knowledge of economic principles and tendencies is invaluable for the guidance of statesmen.

Such then, briefly, is the subject-matter and limits of economics, and its relation to certain other important sciences. As a science it is a study of cause and effect, and is confined to man's activities in, as Marshall remarks, "the ordinary business of life."² The foundations of these activities are the wants of man. The superstructure is formed by the efforts, the labour, the sacrifices, and the patience of man, and it is built up with wealth obtained from a flow of produce or income. Sometimes the wealth is immediately used up to sustain the worker, and to increase his efficiency; sometimes it is set aside for further use in creating additional wealth.

Moreover, it must not be forgotten that economics deals with man as a social being, as a member of society, as an individual in a "herd" with the "herd instinct," as a gregarious animal living in communities. He may, for instance, be one of thousands of workers in a factory, or one

¹ *Principles of Economics* (eighth ed., 1920), pp. 781-2. Alfred Marshall (1842-1924) was Professor of Political Economy in the University of Cambridge from 1885 to 1908. In addition to the *Principles of Economics* (1890), his chief works are *The Economics of Industry* (1892), *Industry and Trade* (1919), and *Money, Credit, and Commerce* (1923).

² *Ibid.*, p. 14.

of many vendors in a town market, or one of a large number of speculative buyers in an organised produce market, or one of the board of directors of a powerful joint-stock company, or one of the partners of a prosperous private business.

Obviously, therefore, we should be particularly cautious in considering the implication of the principal terms that are used in economics, always bearing in mind that their economic meanings do not necessarily coincide with their popular meanings. The term "wealth," for example, leads us to think of such terms as "money," "capital," "property," "income," "stocks and shares," "the national dividend," and probably many others; the term "market" immediately reminds us of "buyers," "sellers," "middlemen," "speculators," "wholesalers," "retailers," "consumers," "producers," "freight," "transport," "mass production," "competition," "monopoly," "rings," "combines," "trusts"; the term "wants" brings thoughts about "labour," "the workers," "the management."

And each of these in turn leads to further trains of thought, to further associations of ideas, as instances of which we may take two of the most important of the preceding—"income" and "property." "Income" suggests at once not only such terms as "earnings," "wages," "salary," "fees," "profits," "rent," "interest" and "dividend," but also the inseparable income tax and the problems of taxation. "Property" makes us think about inheritance and bequest, about great "fortunes," and about the inequality and accumulation of wealth, a train of thought which leads to the taxation of, and the income from, property.

Hence our subject-matter appears to become considerably bigger; we begin to think that economics is in itself a "big business." But as we proceed it will be seen how our economic horizon gradually becomes not only wider and wider, but also more and more interesting, if, of course, we proceed cautiously, carefully considering the significance of the various terms and

always remembering that the fundamentals are the wants of man and his efforts to satisfy these wants.

Thus we return to the first word of this introductory chapter : "wants."

SUMMARY OF CHAPTER I.

The Definition of Economics.—Economics deals with our wants, our efforts, and our satisfactions—with our activities in the business of life.

"Economics treats of all the actions of human beings in relation to wealth." (Chapman.)

"The subject-matter of political economy or economics has always been the wealth of human beings generally." (Cannan.)

"Political economy treats of the wealth of nations ; it inquires into the causes which make one nation more rich than another." (Jevons.)

We are all engaged in the pursuit of wealth either as—

- (1) Wage earners,
- or (2) Property owners,

and frequently in both of these capacities.

The Relation of Economics to other Sciences.—Economics is concerned with the collection of facts, with cause and effect, with tendencies.

The economist is not necessarily an idealist. Ideals and standards of conduct belong to ethics. Some writers think that economics and ethics should be kept apart, while others are of opinion that the economist should consider ideals and morals in his study of the "business of life."

Economics, or political economy, came into existence as a separate study when certain writers attempted to formulate rules for the help of statesmen.

Psychology and history are of great use to the economist. Psychology deals with the workings of the mind, with will power, and behaviour. History helps us to interpret the present with a knowledge of the past. Statistics and mathematics are also invaluable to the economist.

Economics is sometimes regarded as a branch of sociology or the science of society. The old name political economy is really equivalent to social economy.

Economic Terms.—Great care is necessary in examining the meaning of the terms used in economics because the economic meaning is not necessarily the popular or ordinary meaning.

CHAPTER II.

THE FOUNDATIONS.

"If in economics, as in some other things, we find that the foundations are the most difficult part of the work, that is no reason for trying to build a superstructure without any foundations at all."—Cannan, *Wealth*.

We begin, then, by examining briefly the nature of the wants of mankind, and the meaning of the economic term wealth. In economics, when we speak of our wants, which are sometimes referred to as desires, it is implied that we are prepared to make an effort or a sacrifice in order to satisfy them, and not that we are simply longing or craving for certain commodities. Thus, with certain striking exceptions, before we can satisfy our wants by the possession of desirable things, before we can obtain what the economist terms "goods," there must have been a certain amount of effort or sacrifice on the part of someone or other. The striking exceptions are water in streams or in the sea, air, and sunshine, which are accessible to all, and are therefore termed "free goods."

"Free goods" are not man's products; they are not the result of human effort or sacrifice. Consequently they are to be distinguished from the "goods" which are the result of such effort. The latter are termed "economic goods." Water, for instance, becomes an "economic good" after it is conveyed in pipes from a reservoir for the use of dwellers in a town. Its conveyance has required effort, and the users or

"consumers" of such water have to pay a small charge or rate because the water has been brought to their homes.

Thus we have two great classes of goods : (1) free, and (2) economic ; and it is the latter which the economist usually regards as wealth, though it is not inaccurate to include under the broadest meaning of the term wealth free goods as well. Economic goods include all those things that have required effort or labour to produce, and all those services, such as the services of the doctor or the lawyer, which are not to be had free.

To the economist, therefore, goods include not only material things but also the services which persons perform for one another for a remuneration. Thus we may classify goods into : (1) material, which we can handle, and exchange for other goods, and (2) non-material, or personal, which we cannot handle and transfer, such as our own powers of skill and ability. In the former class we must, in addition to ordinary commodities like merchandise, include investments in commercial enterprises, patents, copyrights, and the right to make use of material things ; and the latter class we may subdivide into internal non-material goods or the qualities which lie within ourselves, and external non-material goods, such as the goodwill of a business, which depend on our relations with other members of a community. We may also classify goods into : (1) transferable, and (2) non-transferable, while another classification which is frequently used groups goods according to ownership into : (1) public, municipal, or national, and (2) private.

It is thus evident that goods, that is, wealth in the broadest sense, may be classified in more than one way, but for our purpose it is sufficient to emphasise that the chief feature of goods is that they satisfy our wants, that they possess certain qualities or attributes which make them more or less desirable, more or less agreeable, more or less useful, in brief that they possess what the economist terms "utility."

The utility of a commodity is therefore simply its capacity of fulfilling a want, of satisfying a desire. An article which may be "worthless" to one person, which so far as this person is concerned possesses no utility, may possess a great deal of utility to another person.

Utility is therefore of fundamental importance in economics. We make or produce things because of their utility; we buy, enjoy, or, as the economist states, "consume" things because they possess utility. Furthermore, utility varies. Other things being equal, if we possess a great amount of one commodity, any addition to this commodity will possess less utility than an addition to a possession of half the amount of the said commodity. An addition to our stock of a commodity possesses less utility than a previous similar addition to the same stock, or, in other words, an increase of the stock reduces our desire, our eagerness, our anxiety to acquire more of this particular commodity. By increasing the stock in this way with equal additional increments we ultimately reach a point where instead of acquiring another increment we begin to think about the utility of a different commodity. Thus the utility of an article diminishes as we add to the stock of that article, and this is termed the law of diminishing utility or of satiable wants.

We have now reached another very important fundamental conception. The utility of an article is the basis of our demand for that article; the process is quite clear: wants, utility, demand. In other words, demand depends upon our wants, our preferences, our choice, our comparison of one commodity with another, and also, of course, upon our possession of other commodities. As the stock of a commodity increases the utility of each additional increment decreases until we arrive at a point when no further increment is desired, and the increment which we are almost on the point of not adding to our stock is said to possess marginal or final utility. The utility of the whole stock is termed total utility.

As an illustration of the meaning of marginal utility let us suppose that a person who has purchased five loaves of bread decides to add a sixth to his total stock. The sixth loaf is added because the buyer regards this loaf as the one which he can almost but not quite dispense with. It is his marginal loaf and possesses marginal utility because as Marshall puts it, "he is on the margin of doubt whether it is worth while to incur the outlay required to obtain it."¹

Our next step is to consider the connection of utility with value.

SUMMARY OF CHAPTER II.

Goods.—The satisfying of our wants means the obtaining of what the economist terms "goods," which are classified into—

(1) *Free goods*, such as water accessible to all in streams, which are not man's products.

(2) *Economic goods* which have required labour to produce.

Economic goods, strictly speaking, constitute wealth, but in the broadest meaning of this term we can also include free goods.

Economic goods may be classified into—

(1) *Material goods*, which we can handle and transfer, such as merchandise.

(2) *Non-material goods*, which we cannot handle and transfer, such as skill and ability.

Non-material goods may be divided into—

(a) *Internal non-material goods*, the qualities which lie within our selves, e.g. skill.

(b) *External non-material goods*, which are based on our relations with others, e.g. the goodwill of a business.

We may also classify all goods into—

(1) Transferable.

(2) Non-transferable.

or, according to ownership into—

(1) Public, municipal, or national.

(2) Private.

¹ *Economics of Industry*, pp. 62-3.

Utility.—Goods possess certain qualities which make them more or less desirable. In other words, they are said to possess utility. The utility of a commodity is its capacity for fulfilling a want, of satisfying a desire. The demand for a commodity depends on its utility, i.e. utility is the basis of demand.

The Law of Diminishing Utility.—Utility is of fundamental importance in economics. As our stock of a commodity increases each addition to it possesses less utility than the previous addition, or, in other words, each additional utility, satisfaction, or benefit a person derives from an increase to the stock tends to get less and less as the stock increases. The economist calls this tendency the law of diminishing utility.

Marginal or Final Utility.—This is the utility of that portion of our stock of a commodity which we are almost on the point of not adding to our stock, i.e. the utility of the final addition to the commodity.

Total Utility.—This is the utility of our whole stock of a commodity, i.e. the total satisfaction it gives to the possessor.

CHAPTER III.

VALUE.

"The value of a commodity means in economics its power of commanding other commodities in exchange."—Taussig, *Principles of Economics*.

In commercial advertisements we often see such announcements as "splendid value," "we give value for money," "go to Wilson's for value," "we stock no valueless goods," and in our ordinary conversation we frequently make use of such phrases as "the value of the Bible," "the value of clothes," "the value of vitamins," "the value of argument" and "the value of rubies."

These examples show that in popular usage varying shades of meaning are attached to the term value. It is, for example, obvious that value in the phrase "the value of the Bible" has not quite the same meaning as value in the phrase "the value of rubies." The loose way in which the term value is used in everyday language shows the necessity of a thorough grasp of the economic meaning.

In economics there are no varying shades of meaning to value. To the economist value is a relative term; it expresses the rate which an article will exchange for another or for others. This is what the earlier economists described as "value in exchange," which must be carefully distinguished from what they termed "value in use," which modern economists call utility. The difference is thus explained by Adam Smith: "The word value has two meanings, and sometimes expresses the utility of some particular object and sometimes the power of purchasing other goods which the

possession of that object conveys."¹ "Value," states Walker,² "is the power which an article confers upon its possessor of commanding, in exchange for itself, the labour, or the products of the labour, of others."

In explaining the theory of value we can begin by saying that the value of a commodity depends upon demand and supply, bearing in mind that the explanation of value is not quite so simple as this, for we may also say that demand and supply depend on value. Demand, supply, and value react upon one another. It is because things possess value that they are produced. A shortage in the supply may enhance the value of a commodity; a decrease in the demand may lower the value; a rise in value may increase the supply.

From the standpoint of the consumer or purchaser the value of a commodity will depend upon its utility, and from the standpoint of the producer it will depend upon its cost of production. We will first of all examine the connection of utility with value.

The utility of a commodity, as has just been stated, diminishes as the stock of the commodity increases, until at last we arrive at a point when we begin to think about the utility of another commodity. If, for example, a person decides to buy 4 lb. of meat he will, before purchasing, consider the utility of the fourth or marginal pound, and compare its utility with the utility of some other commodity such as a pound of butter or of cheese. The buyer decides upon the fourth pound of meat because he thinks that its utility as measured by the price is greater than the utility of the pound of butter or cheese.

¹ *The Wealth of Nations* (Everyman's Library edition), Vol. I., pp. 24-5. Adam Smith (1723-90) was born at Kirkcaldy. In 1751 he was appointed Professor of Logic, and in 1752 Professor of Moral Philosophy in the University of Glasgow. He resigned, and was abroad from 1759 to 1766. In the latter year he returned to Kirkcaldy and commenced to write the *Wealth of Nations*, which was published in 1776.

² *Political Economy*, p. 5.

Now, if in the preceding illustration we regard the utility of the marginal pound of meat as the measure of the value of each pound of meat purchased, we may say that the value of the beef depends on its marginal utility, or, in other words, on the utility of the marginal pound.

This is what economists term the marginal utility theory of value, and it must be noted that the position of the margin varies with the buyers in accordance with their estimate of the utilities of the commodities they desire, and with the size of their income.

We must now consider the problem of value from the standpoint of the producer, that is to say, from the standpoint of supply, or cost of production. But before we examine the meaning of cost of production we must remember that an article, such as a painting by Romney, or a Chippendale cabinet, or a Jacobean Bible, may be valuable because it cannot be re-produced; its value is due to scarcity, and, therefore, in a rare article of this nature, cost of production does not influence value.

Cost of production is sometimes distinguished from expenses of production, or the actual sums of money paid by a producer before a commodity is placed on the market. Those who make this distinction include under cost of production not only the money paid but also the efforts and sacrifices of the workers, and the waiting of the capitalist. Some economists regard cost of production as being made up of what they term "prime costs" and "supplementary costs," including under the former the wages of labour and the money spent on raw material, and under the latter such charges as rent, taxes, rates, and what Marshall terms the "salaries of the upper employees."

But cost of production may also be divided into costs of manufacture and costs of selling, which is a very important distinction, because in many commodities the selling costs exceed, in fact are sometimes five or six times greater than, the

manufacturing costs. This will be evident when we realise that selling costs include the expenses of the middleman, transport charges, and money spent on advertising.

Now the cost of production varies from firm to firm. If, for example, four equal-sized firms are engaged in producing a certain type of boot which is sold at a guinea a pair, there will be a variation in the efficiency of the firms, and therefore their cost of production will vary. Each firm in order to carry on will have to produce a pair of boots for less than a guinea. Let us suppose that it costs the least efficient firm twenty shillings to place a pair of boots on the market, and that the other firms are able to do this for 17s., 18s., and 19s. respectively. The value of the boots, therefore, depends on the cost of production of the least efficient firm, the firm which is on the margin and which just manages to carry on. If, of course, the other three firms decided to sell the boots for 19s. 6d., then the least efficient or marginal firm of the original four would cease to exist, and the new marginal firm would be the one which produced a pair of boots for 19s.

This is the cost of production theory of value, and it will be noted that it describes how the value of a commodity depends on the costs of the marginal firm. The theory, however, as we have seen, does not explain scarcity value, nor does it account for any changes in the value of a commodity after it is placed on the market. We shall return to the marginal utility and the cost of production theories of value a little later when we discuss the theory of price.

Thus, according to whether we analyse the problem of value from the side of demand or from the side of supply, we have the marginal utility theory, which that famous nineteenth century economist, Stanley Jevons,¹ supported after "re-

¹ William Stanley Jevons (1835-82) was born in Liverpool. In 1866 he became Professor of Logic and Moral Philosophy in Owens College, Manchester, and from 1875-80 was Professor of Political Economy in University College, London.

peated reflection and inquiry,"¹ and the cost of production theory, which an earlier and equally famous nineteenth century economist, David Ricardo,² championed, and who as a result, in Jevons' opinion, "shunted the ear of economic science on to the wrong line."³ Marshall clearly illustrates these two theories by comparing them with a pair of scissors. "We might," he states,⁴ "as reasonably dispute whether it is the upper or lower blade of a pair of scissors that cuts a piece of paper as whether value is governed by utility or cost of production."

But there is yet another theory which seeks to explain the problem of value from the side of supply. This is the labour theory of value. Adam Smith regarded labour as "the real measure of the exchangeable value of all commodities."⁵ "Labour," he tells us,⁶ "is the only universal as well as the only accurate measure of value, or the only standard by which we can compare the values of different commodities at all times and at all places." Ricardo states that labour is "the foundation of all value," and that "the relative quantity of labour" determines "the relative value of commodities,"⁷ while Karl Marx declares that the "values" of commodities may be looked upon as "crystals" of "human labour power."⁸

The labour theory, obviously, is weak, not only because it regards the problem of value from the standpoint of supply and ignores the demand for an article, but also because it does not explain how we are to assess the various grades or qualities of labour which are often necessary to produce a commodity.

¹ *The Theory of Political Economy* (1879), p. 1.

² Ricardo (1772-1823) was of Hebrew extraction and an expert in high finance. In 1817 he published his most important work—*The Principles of Political Economy and Taxation*. ³ *The Theory of Political Economy*, Preface, p. lvii. ⁴ *Principles of Economics*, p. 348.

⁵ *The Wealth of Nations* (Everyman's Library edition), Vol. I., p. 26.

⁶ *Ibid.*, p. 32. ⁷ *Principles of Political Economy and Taxation*, p. 12.

⁸ *Capital* (English translation, 1887), Vol. I., p. 5. Heinrich Karl Marx (1818-83), the socialist writer was born at Trier. His chief work *Das Kapital* (*Capital*) was published in 1867.

price would lead to a big demand for these commodities among these classes.

Then, again, we must not forget that the demand for, or supply of, an article frequently depends upon the demand for, or supply of, other articles. There are countless illustrations of this, particularly in the business of farming, which, as is well known, is a network of interdependent pursuits. Take strawberries for example. The strawberry grower requires a great deal of barley straw, therefore the demand for strawberries leads to a demand for barley straw. This is what is termed joint demand, and is due to the interdependence of products. As another illustration of joint demand let us suppose there is a demand for houses. This will result in a demand for mortar, timber, bricks, slate, tiles, waterpipes, etc., and for the labour and capital which produces these commodities. The demand for houses is termed by economists a direct demand, and the demand for mortar, timber, etc., an indirect or derived demand. The demand for mortar, timber, etc., is also, of course, a joint demand.

This demand for commodities required to make another commodity is of great importance in modern wage problems. Thus a derived demand for labour in house-building results in the employment of various types of workers such as unskilled labourers, bricklayers, carpenters, plasterers, plumbers, and painters. Other things remaining the same, it is obvious that a decrease in the number of one group of workers, or an increase or decrease in their output, or a reduction or increase in their wages, will immediately affect the work of the other groups. It is therefore quite possible that a reduction in the supply of carpenters who are urgently needed for the erection of new houses might result in the carpenters, secured by an employer for this particular work, receiving a higher wage than their usual rate of pay, and this in turn might result in a reduction of the wages of the workers whose supply is not reduced.

Furthermore, we may also have what is termed a composite demand. A commodity may be demanded because it may

be put to alternate uses. Coal, for instance, has a wide range of uses. On the other hand, supply is said to be composite when it is obtained from different sources, or, if a manufactured article, from different firms. Beef, mutton, pork, and venison form a composite supply of meat. Articles may also be produced jointly from a common origin such as gas and coke, mutton and wool, beef and hides, cotton and cotton seed. Thus we have a joint supply which is analogous to joint demand, the lesser commodity in a joint supply being usually termed a by-product.

These conceptions—joint demand, joint supply, composite demand, composite supply—are of considerable importance in the study of economics. It does not need very deep thinking to realise that more than one source of supply or the joint supply of a commodity may greatly affect the problem of prices. If, say, in the case of coal, new sources are discovered and worked, and as a result much bigger supplies placed on the market, prices will tend to fall. If the sources of supply of a commodity, or most of these sources, get into the hands of one firm, then the prices of this commodity will tend to rise, and the buyers will be subject to a monopoly price. And so in the case of a joint supply like wool and mutton, if the demand for one of them increases, then there will be an increase in the supply of the other, and the price of the commodity whose demand is not increased will tend to fall. Similarly, if two articles like bricks and mortar are jointly demanded for house-building, a decrease in the supply of one will tend to produce a decrease in the supply of the other; if, to use a previous illustration, the strawberry crop in one of the home counties failed, then barley straw in that particular county would be almost unsaleable.

Now let us apply this analogy to labour and capital. What, for example, will be the result of an increased supply of capital upon the demand for labour? We cannot answer this question by declaring in an emphatic way that there would be

an increased demand for labour because the increased supply of capital may not be used for productive purposes. But if the additional supply of capital is used for constructing factories, installing new machinery, and obtaining raw material, and if in this way it increased the supply of commodities, thus tending to make them cheaper and increase the demand, we can say that there will almost certainly be an increased demand for labour.

SUMMARY OF CHAPTER III.

Theories of Value.—Value is a relative term; it expresses the ratio which an article will exchange for another or for others. This is what the earlier economists termed value in exchange as distinguished from value in use. There are three theories of value—

(1) *The Marginal Utility Theory*, based on the demand for a commodity. The value is stated to depend on a commodity's marginal utility.

(2) *The Cost of Production Theory*, based on the supply of a commodity. The value of a commodity is stated to depend on its marginal cost of production (i.e., the cost of production of the marginal firm).

(3) *The Labour Theory*, also based on supply. The value of a commodity is stated to depend upon the amount of labour expended in producing it.

Cost of Production and Expenses of Production.—Cost of Production means all the efforts, sacrifices, and waiting involved, together with all the money spent, in producing an article. The expenses of production are the actual money costs.

Prime Costs and Supplementary Costs.—The former cover the money cost of the raw material actually used in the manufacture of a commodity, and the wages of the workers who are directly engaged in making the commodity. Supplementary costs include the other charges such as taxes and rates.

Manufacturing Costs and Selling Costs.—This is another analysis of the money cost of production. Manufacturing costs are the total expenses incurred by the factory in the process of manufacturing a commodity. Selling costs are the expenses incurred in getting the article to the consumer; they include the expenses of transport and advertising.

Consumer's Surplus.—The value of a commodity to a consumer in terms of money may not be represented by its market price. It often happens that consumers are prepared to pay more for an article than they actually do, such as in the case of necessaries like bread. The gain to the consumer in cases of this nature is termed *consumer's surplus*. Thus in the case of bread *consumer's surplus* is said to be very high.

Elasticity of Demand.—A small drop in the price of some articles may cause a big increase in the amount sold. Here demand is said to be very elastic. But if a small drop in price does not affect the amount sold, or affects it very little, then demand is said to be inelastic.

Joint and Composite Demand.—These are distinguished as follows:—

(1) *Joint Demand*, when the demand for one commodity means the demand for another commodity, e.g. strawberries and barley straw.

(2) *Composite Demand*, when a commodity is demanded for alternate uses, e.g. coal.

Joint and Composite Supply.—These are thus distinguished—

(1) *Joint Supply*, when produced from a common source, e.g. gas and coke.

(2) *Composite Supply*, when obtained from different sources, e.g. beef, mutton, pork, and venison from a composite supply of meat.

CHAPTER IV.

PRICE.

"Civilised countries generally adopt gold or silver or both as money. Instead of expressing the values of lead and tin, and wood, and corn, and other things in terms of one another, we express them in terms of money in the first instance, and call the value of each thing thus expressed its price."—Marshall, *Principles of Economics*.

Price may be defined as the money measure of value, and for all practical purposes it is the market measure. It is the amount of money which a commodity will exchange for.

An article may be valuable and yet not be priced because it is not for sale; we may value commodities without the use of money. The value of an article depends on a direct comparison of article with article, whereas the price of an article depends on a comparison by means of another commodity, money, the medium of exchange. "It is a mistake," writes Professor Cannan, "to say that the value of a commodity in the medium of exchange is just the same thing as its price. Every commodity has a value in the medium of exchange, but not every commodity has a price."¹

The distinction between value and price is well illustrated in the case of a commodity like gold. In England gold has three prices, the Mint price, and the Bank of England price, which are fixed by law and which never vary, and the market price², which may vary daily. But the value of gold depends

¹ *Elementary Political Economy* (1888), p. 69.

² For details about the Mint, Bank of England, and market prices of gold, see Chapter XIV., *infra*.

on the amount of other things it exchanges for, or, in other words, its purchasing power.

The price of a commodity under conditions of free competition depends on the forces of demand and supply. "The price," states Marshall,¹ "may be tossed hither and thither like a shuttlecock, as one side or the other gets the better in the 'higgling and bargaining' of the market." From the buyer's standpoint the price of a commodity will be governed by his desire to obtain it, and by the amount of money which he can spare for the purpose of buying it. The desire to obtain the commodity depends on its marginal utility, therefore, from the standpoint of the consumer, price is the measure of the marginal utility of a commodity.

An illustration will make this clearer. Let us suppose that a buyer decides to buy 10 lb. of apples. The tenth, or marginal, pound is the limit of his desire for apples, the additional pound which he is almost on the point of not purchasing, and which is termed the marginal purchase. Now if he is just willing to pay 2d. for a pound of the apples, the 2d. is his measure of their marginal utility, and is therefore his marginal demand price.

But, as in the theory of value, the supply side has also to be considered. From the standpoint of the producers the price of a pound of apples depends on the costs incurred by the marginal fruit grower, the fruit grower who works under the least advantageous conditions, whose transport charges may be the highest, or whose apple trees are the least prolific. Thus we have a marginal supply price as well as a marginal demand price, and when these two prices are equal we have the market price.

The demand for, and the supply of, a commodity, therefore, both help under ordinary conditions to fix its price, but the effects of these two forces may be interfered with by rings of sellers, or by the method of paying for commodities in

¹ *Economics of Industry* (third ed., 1919), p. 192.

instalments, what the American calls instalment buying and the Englishman the hire purchase system.¹ When, however, the price is fixed and the demand for a commodity exceeds the supply, then the price tends to rise, other things, of course, remaining the same; and when the supply is in excess of the demand the price tends to fall. Then, again, if the price falls the demand tends to increase and the supply to decrease, and if the price rises the demand tends to decrease and the supply increase. Thus price, if demand and supply are allowed free play, always tends to remain at a certain level, the level it reaches when demand and supply equate one another, while under these conditions it is quite evident that not only does price depend on demand and supply, but that demand and supply also depend upon price.

These are important economic "laws," and it will be noted that the term "law" is really equivalent to "tendency" for such laws are not so exact as those of physics or of chemistry. We therefore guard ourselves by assuming that other things remain the same, such, for example, as the purchasing power of money, but even with this assumption we can never be certain that, when the supply of an article exceeds the demand, the price will actually fall, because we can never be certain how man himself will act. Man is a "volitional creature" possessing a will and acting according to certain motives, therefore he can, if he so desires, prevent such tendencies.

The preceding laws of supply and demand apply not only to material commodities but also to services and to capital. They are quite as evident in the demand for labour or the supply of capital. An increase of the price, *i.e.* the wages, offered to labour in a certain industry tends to increase the supply of labour for that industry; a decrease in the price, *i.e.* the interest, of capital demanded for a certain industry tends to reduce the supply of capital forthcoming for the

¹ Instalment buying is discussed in Chapter XI., *infra*.

needs of this industry. The demand for a commodity depends on the wants of the consumer together with the sum he is willing to pay, and the amount he can spare. The supply may depend on scarcity, on monopoly, or on the cost of production.

In every market—the produce market, the labour market, and the capital market—there is, therefore, the demand price of the buyers, and the supply price of the sellers. From the buyer's standpoint the price of a commodity tends to equal the money measure of its marginal utility; from the seller's standpoint the price tends to equal the cost of production of the marginal firm. It is the balancing of these two prices that decides the market price.

Some economists, however, make a distinction between market price and what they term “normal” price. The latter is regarded as the price which is arrived at in a longer period of time, or, in other words, a kind of average price which is brought about in a run of time sufficiently long to enable economic forces to operate, and round which the market price tends to hover. The longer the period the better will the producer be able to adjust the supply to the needs of the buyers. The market price, on the other hand, is arrived at with the supply actually in hand, or near at hand; there is no time to make any big additions, as, for example, in a fish, meat, or vegetable market, when the supply is usually what is shown in the market.

This is the time element in the problem of price, and it is very evident in such markets as fish, meat, or vegetable where perishable goods are sold. The influence of demand in these cases is very strong in settling the price because the supply of the commodity is usually the stock in sight. The longer the period in which supply can be adjusted the greater will be the influence of supply on price. In long periods of time, therefore, the price of an article will be more influenced by the cost of supplying it, that is by the cost of production.

We must also distinguish between a rise or fall in the price of one commodity and a rise or fall of price in general. Changes in general prices, or what the economist refers to as changes of the price level, often give rise to serious economic problems, and during the last hundred years there have been big fluctuations in this respect. In his *Introduction to the Study of Prices*, Mr. Layton traces with great clearness the history of these fluctuations during the nineteenth century. He examines the causes of the changes in the general level of prices, and shows that between 1820 and 1900 there were two periods of rising prices, 1849-74 and 1896-1910, and that both these periods were preceded by periods of falling prices.

Before the war these changes in price levels were fundamentally due to a rise or fall in the production of gold. But owing to the fact that during the war period gold went out of circulation the very high prices immediately after the war were primarily due to the great increase of paper money accompanied by a decrease in the output of commodities. This is what is termed inflation, a subject which we shall have to examine in more detail in a subsequent section.¹

We must next consider how changes in price levels are measured. How, for example, is it possible for economists to state that prices in any one month are approximately 50, 60, or 70 per cent. higher than they were fifty or sixty months previously? Changes in prices are measured by means of index numbers.

An index number has been defined by Mr. Layton as "a device for ascertaining the average change in the prices of a number of commodities."² There are at present several types of index numbers in use in various countries, but the underlying methods of construction are the same in each type. In England there are three important ones, those published in

¹ See Chap. XVI., *infra*.

² *Introduction to the Study of Prices* (1922), p. 147.

the *Economist* and in the *Statist*, and that issued by the Government through the Board of Trade.¹

Index numbers are constructed by taking a large number of typical commodities in every-day use, and comparing their wholesale prices at different intervals. There are, however, obvious difficulties in making our calculation such as the number, and the selection, of the commodities, detecting changes in quality over a number of months or years, and estimating the relative importance of each article included.

The equalising of the importance of the commodities selected is sometimes done by means of what is termed "weighting." Take wheat, for instance. If buyers spend four times as much money on wheat as they do on cotton, then wheat may be "weighted" in calculating the index number as four articles and cotton as one. "The general principle according to which the weights are to be assigned," states Professor Edgeworth,² "is that they should represent the importance of the commodity to the consumer." A "base" or "standard" year is then taken, and the changes in prices of the selected commodities are expressed in percentages of the prices of these commodities in the "standard" year. So, if 1913 is our "standard" year, and we find, say, tea marked as 159 for 1926, then we know that the wholesale price of tea was in the latter year 59 per cent. higher than in 1913 for which year the price would appear as 100.

Now if this method is applied to say 45 different articles in common use, and we decide to attach equal relative importance to each article, which, considering the difficulties of "weighting" some of the articles selected, is a method frequently employed, our index number would then be calculated by

¹ It must, however, be noted that certain important newspapers like *The Times* and the *Financial Times* publish their own index numbers.

² Article entitled "Index Numbers" in Palgrave's *Dictionary of Political Economy*.

simple addition or by simple averaging. Thus, taking our "standard" year to be 1913, under which, of course, each of our 45 commodities would be marked as 100 with a total of 4,500, let us suppose that the total of our prices for the 45 in 1914 came to 4,545. Then we could either find the average price of each article, *i.e.* 101, from our new total, which would be our index number for 1914, or we could, by taking 4,500 as the index number of our "standard" year, regard 4,545 as the index number for 1914.

The preceding example illustrates the simplest type. It, however, shows the underlying principle, for all index numbers, elaborate or simple, "weighted" or not "weighted," are fundamentally based on averages, and owing to the difficulties which have just been discussed, can never be calculated with absolute accuracy. An index number is simply a method of measuring fluctuations approximately. It can be applied not only to wholesale prices but also to other things such as imports and exports, wages, or the cost of living (retail prices), while it can be calculated weekly, monthly, or yearly.

The *Statist* index number, for instance, is calculated on the wholesale prices of 45 foodstuffs and materials, is "weighted," and is published monthly. It is a continuation of a series of index numbers compiled by Sauerbeek for the years 1846 to 1912, in which the compiler took as his "standard" the average wholesale prices for the eleven years 1867 to 1877, giving to each commodity the average wholesale price of 100. As continued by the *Statist*, the index numbers for the month of January in the years 1914, 1916, 1918, 1920 and 1921 respectively, are: 83.5, 123.6, 186.2, 245.3, 197.2.

Another very important index number is that published by the Ministry of Labour in its *Gazette*. This is a cost of living index number which is an ingenious attempt to calculate average monthly changes in the cost of living based on the retail prices in four groups: 15 articles of food, "weighted"; rent; clothing; fuel and light.

In the first group 8 out of the 21 items are beef and mutton prices both of which are classified into: (1) British, and (2) chilled or frozen, and which are each subdivided into two classes according to the quality of the meat, the price per lb. being quoted in each instance. The other food articles are: bacon (per lb.), fish (per lb.), flour (per 7 lb.), bread (per 4 lb.), tea (per lb.), granulated sugar (per lb.), milk (per quart), fresh butter (per lb.), salt butter (per lb.), cheese (per lb.), margarine (per lb.), fresh eggs (each), potatoes (per 7 lb.). Two separate index numbers are given, one for the preceding group and one for all groups. The "standard" year (100) is 1914, but the average increase is not, as in the *Statist* and the *Economist* index numbers, added to the average "standard" price.

Furthermore, the Ministry of Labour cost of living index number gives three separate percentages for the food group. The first appertains to food prices in towns with a population of over 50,000, and the second to food prices in small towns and villages, while the third gives a general average. Thus for Feb. 1933 these three index numbers were 22, 21, 22, respectively, each number, of course, representing an average "weighted" percentage increase, so that the general average food price for the country would be represented by 122 in February 1933 as compared with 100 in 1914. (Appendix 1.)

In connection with the clothing group the compilers emphasise the difficulties of calculating an index number. "As regards clothing," it is stated, "owing to the wide range of quotations, both now and before the war, to changes in qualities and in stocks held by retailers, and in variations in the extent to which different articles and qualities have been affected by price changes, it is impossible to make an exact calculation of the increase in prices." The rent group includes the various rates, and the fuel and light group such items as gas, coal, oil, candles, and matches.

Though approximations, the results of these calculations are, owing to the careful selection of the commodities, the

"weighting," and the distinction between large and small town retail prices, near enough to give us an extremely valuable idea of the rise in the cost of living since 1914. The ten Ministry of Labour cost of living index numbers, representing the four groups detailed above, for the month of June in each year from 1918 to 1927 are: 100 (*i.e.* twice as high as 1914, a doubling of prices in four years), 105, 150, 119, 80, 69, 69, 72, 68, and 63.

SUMMARY OF CHAPTER IV.

Price.—A distinction must be made between price and value. Price is the money measure of value.

From the standpoint of the consumer price measures the marginal utility of a commodity. This is the marginal demand price. But there is also a marginal supply price, which depends on the costs of production of the marginal firm. When marginal demand price and marginal supply price are in equilibrium, then we have the market price.

The operations of demand and supply, however, may be interfered with by rings of sellers who fix prices, or by instalment buying.

The "Laws" of Demand and Supply.—The fundamental "laws" or tendencies of demand and supply are—

- (1) When demand exceeds supply price tends to rise.
- (2) When supply is in excess of demand price tends to fall.
- (3) If price falls demand tends to increase and supply to decrease.
- (4) Price depends upon demand and supply, and demand and supply upon price.

Market Price and Normal Price.—The market price is subject to incessant variations; it depends on the "higgling" of the market and the balancing of marginal demand price and marginal supply price.

The normal price is the price round which the market price oscillates. It is the price arrived at in a period of time sufficiently long enough to allow economic forces to operate. The producer is thus able to adjust the supply in accordance with the demand.

Changes in Price Levels.—An increase in the quantity of money (accompanied by a decrease in output) will result in rising prices.

Before the war changes in price levels were fundamentally due to

a rise or fall in the production of gold. One of the great causes of the post-war high prices was the great increase in the use of paper money.

Index Numbers.—Price fluctuations are measured by means of index numbers.

Index numbers are constructed by taking a number of commodities in everyday use such as bread, tea, meat, flour, coal, and iron, and comparing their wholesale prices at different periods with those of a selected year, say 1913, which is termed the "standard" or "base" year. The prices for the standard year would all be regarded as 100 and any changes are expressed in percentages.

The index numbers of the *Statist*, the *Economist*, and the Ministry of Labour are outstanding examples.

[A specimen cost of living index number taken from the *Ministry of Labour Gazette* is given in Appendix 1 *infra*.]

CHAPTER V.

INCOME.

"Income may be defined as the wealth, measured in money, which is at the disposal of an individual or a community, per year or unit of time."—F. Y. Edgeworth in *Palgrave's Dictionary of Political Economy*.

Wants, utility, demand, value, and price, lead to the important question of income. More or less of a commodity is bought according to whether the income of the buyer is big or small. We may, of course, obtain commodities as gifts, by inheritance, by appropriation, and by barter. Buying, however, is the customary method of obtaining possession of commodities in civilised countries.

But what is income? Income is really a flow of services and commodities, or rather the value of such a flow. It may include receipts in kind received regularly like money payments, but it is usually understood to mean incoming money. It may be described as an amount of wealth obtained by an individual or a community during any period of time, and is therefore to be distinguished from capital, which, as will be explained in more detail later, is a quantity of wealth in existence at a particular moment. Capital is used to produce further wealth. Income is derived from capital; it is a stream of wealth, and is constantly being converted into capital.

We must, therefore, carefully distinguish between what the economist terms "money" income and "real" income. The latter consists of commodities and services, the necessities and luxuries, obtained by means of the former. Strictly speaking "real" income includes not only the services we

pay for, such as those of the doctor, the lawyer, or the butler, but also the services we ourselves perform for ourselves, and the services performed free of charge by members of a family for one another. Indeed, we may even take a broader meaning and regard income as including all utilities or satisfactions. Thus a bicycle, or a table, is a regular source of utility or satisfaction for many years, and, as Professor Taussig has emphasised, we derive in this way a great deal of what he calls "psychic" income.¹ But such income is not measurable, and though we may feel quite certain that "psychic" income has greatly increased in a country like England during the last hundred years, we usually confine our attention to "money" income and its command over "real" income.

Income is really the core of our study, for as Marshall states, economics is an investigation of how man, through his "activities in the ordinary business of life," "gets his income and how he uses it."² Economics is concerned with the sources, the classification, the fluctuations, and the inequality of income.

There are, as we have already seen, only two kinds of income receivers, workers and owners, and therefore only two sources of income, work and property. But it is usual in everyday language to apply the phrase "the workers" to those that use physical effort, that toil heavily with their hands, in order to obtain their income. Hence the term "the working classes." But the term "workers" has in economics a much wider meaning than this. It includes the mental workers, the so-called "genteel" or "middle class" workers, and such high salaried people as the organisers and managers of industry. Thus the term "working classes" really includes all types of wage earners from those engaged in the most unskilled form of manual labour to those engaged in the highest form of brain work.

¹ *Principles of Economics* (third ed., 1924), Vol. I., pp. 130-1.

² *Economics of Industry*, p. 1.

It is, however, becoming more and more customary for workers to be also property owners. Many thrifty wage earners possess this other source of income; they may be part owners, or even the sole owners, of a house or a field from which they obtain rent; they may have invested some of their savings in a big company, and these investments will provide income in the form of dividends. A recent striking illustration of the growth of investment among the workers occurred in the early part of 1927 when two great British railway amalgamations, the London Midland and Scottish and the Southern, decided to increase their capital by £5,000,000 and £1,000,000 respectively, and to invite their employees to subscribe parts of these amounts. The railway workers' response to this invitation was a remarkable one. The specified amounts were not only quickly subscribed but also greatly over-subscribed.

A consideration of income from property opens up big problems. Large-scale production under competitive conditions has resulted in the accumulation of surplus income which has been invested in property. Some of our modern millionaires have built up "fortunes" in this way. But there are others whose "fortunes" are due to non-competitive conditions such as monopoly or inheritance, and yet another class to certain fortuitous, or accidental, circumstances which are not beneficial to a community, such as war or shady speculative dealings.

This brings us to the great problem of the inequality of incomes, and in considering this it is necessary to remember that among the workers vigour, ability, enterprise, organising power, experience, and prevision are important factors in causing their incomes to vary. Inequalities, however, are far more evident when we compare the incomes derived from work with those derived from property. There are also great inequalities among property incomes which are due to the inheritance of unequal amounts, to an increase in the value of

the property inherited, and also to the unequal savings of those that inherit such property.

The second of the causes of inequalities among incomes from property is particularly noticeable in the incomes derived from urban sites in great cities, sites which have increased in value with the expansion of these cities usually through fortuitous circumstances and not as the result of any effort on the part of the owner. London, Liverpool, and Manchester contain some remarkable and well-known examples of such urban sites from which the owners obtain particularly large incomes under non-competitive conditions.

It will thus be seen that the study of income is not so easy as at first sight would appear. An individual's income is that which comes in regularly, weekly, monthly, or quarterly, usually in money, and if in kind is measurable in terms of money. A nation's income, or national dividend, as it is termed, is the total of all commodities and services produced in a country during a certain period. National income has been defined by Sir Josiah Stamp as "the aggregate money expression of those goods produced and services rendered by the inhabitants of the country in a year, which are, as a fact, generally exchanged for money."¹ Thus, as Marshall states: "Everything that is produced in the course of a year, every service rendered, every fresh utility brought about is part of the national income."²

When an individual obtains his income it is used in various ways, the most important of which is as payment for commodities or services. Part of it is used for the payment of taxes; part of it may be given away as a bequest or in the form of charity; part of it may be put aside for future use or loaned to others to make use of.

The amount of an individual's, or of a nation's, income depends upon the amount of wealth produced, that is, upon

¹ *Wealth and Taxable Capacity* (1922), p. 40.

² *Economics of Industry*, p. 52.

production. Low output lessens both individual and national incomes, high output increases these incomes. A high output in a country means greater comforts, a greater satisfaction of needs other than the primary ones, and a higher standard of living among the workers; a high output enhances the dignity of labour.

Output or production according to the old economists depends upon what they termed three "factors" or "agents": land, labour, capital; and corresponding with these agents they classified incomes into the rent of land, the wages of labour, and the profits of capital. Modern economists have added a fourth agent, organisation or management, and they include a fourth kind of income called interest. Thus, applying this classification to the human factors, we may say that the landlord obtains rent, the worker wages, and the capitalist interest and profits.

But, it will be asked, what is the income or share of the organiser termed? That, of course, depends on what his functions are. If he is simply a paid manager, or director, of a business then, like other workers, he receives his wages or earnings—the wages of management or superintendence. But if he has invested some of his surplus earnings in the enterprise which he manages then he will also receive interest on such investments, that is to say, as a wage earner and a capitalist he will receive earnings plus interest, and if the business is a very successful one he will also receive something in addition to this. Suppose, for instance, that he has invested in the business £100 at 5 per cent., and that after a year's trading he receives, say, 7 per cent. This is termed his dividend and represents both interest on his investment, and a share of the profits. The sharing of income into rent, wages, profits, and interest will be examined more minutely in subsequent chapters.¹

¹ See Chaps. IX. and X., *infra*.

We are now in a position to describe in more detail the four "agents" of production—land, labour, capital, and organisation.

SUMMARY OF CHAPTER V.

Income.—Income is a flow of services and commodities, but it is usually understood to mean the value of such a flow in terms of money.

Money income must be distinguished from real income, which includes all the commodities and services obtained by means of the former. Real income also includes the services we perform for ourselves, and the services which we obtain free of charge.

Income is really the core of economics. Of the two great classes of income receivers (workers and owners) the workers include all types of wage earners from the lowest grade of labourer to the highest salaried official.

In both classes incomes vary considerably. Among the workers these variations are due to differences in ability, vigour, and organising power. Great inequalities among incomes from property may be due to the inheritance of unequal amounts, to an increase in the value of the property inherited, and to unequal savings.

A nation's income or national dividend is defined by Sir Josiah Stamp as "the aggregate money expression of those goods produced and services performed by the inhabitants of the country in a year, which are, as a fact, generally exchanged for money."

Income depends upon the amount of wealth produced, upon output or production, and this in turn depends upon four "factors" or "agents." These are—

- (1) Land.
- (2) Labour.
- (3) Capital.
- (4) Organisation.

The Classification of Income.—Income is classified into—

- (1) The rent of land.
- (2) The wages of labour.
- (3) The interest and profits of capital.

The income of the organiser depends on what his functions are. If he is a paid manager of a business then he receives wages, i.e. the wages of superintendence, and if he invests some of his surplus earnings in the business then he will also receive interest on his capital.

CHAPTER VI.

THE AGENTS.

"Producing is making utilities. . . . The absolutely indispensable agents of production are labour and land."—Sir Sydney Chapman, *Outlines of Political Economy*.

It was not until 1803 that the term production was first applied to a division of economics. In that year a well-known French economist, Jean Baptiste Say,¹ published his popular *Traité d'Économie Politique*, a treatise which is divided into five "books," the first of which is entitled "Production."² Eighteen years elapsed before an English economist made use of the term in the same way as Say had done. In 1821 James Mill published his *Elements of Political Economy*, and the first chapter in this important little book is entitled "Production."³

Production is the preparation and adaptation of material for the prospective users, or, in other words, the "creation of utilities." It involves, as we have seen, four "agents" or "factors": land, labour, capital, and organisation; and it depends on the co-ordination of these agents, agents which must now be briefly described.

¹ 1767-1832.

² De la Production. It is interesting to note that the five "books" of the first (1803) edition of Say's *Traité* are entitled: (1) De la Production (Production), (2) Des Monnaies (Money), (3) De la Valeur des Choses (Value), (4) Des Revenues (Incomes), (5) De la Consommation (Consumption).

³ Mill divided his *Elements* into four chapters: (1) Production, (2) Distribution, (3) Interchange, (4) Consumption. James Mill (1773-1838) was an official of the India Office, and the father of John Stuart Mill.

Land has been termed the "mother of wealth." "Everything useful to the life of man," writes Hume,¹ "springs from the ground." It must, however, be noted that under the term "land" the economist includes not only the soil, and what Ricardo terms its "original and indestructible powers,"² but also water, sunshine, and all the gifts of nature. It would thus be better to refer to the first agent of production as nature power, natural resources, or even nature. Marshall speaks of the "utilities over the supply of which man has no control," and applies the term land to the "permanent sources of these utilities."³

In view, however, of the recent great development, and of the immense possibilities, of hydro-electric power we might now even regard water as a separate agent of production. Take Canada, for example, with its enormous water resources. The rapid increase in the use of hydro-electricity in this vast and progressive Dominion is well illustrated in the Reports of the Toronto Electric Commissioners. These Commissioners are the biggest consumers of the current supplied by the Hydro-electric Commission of Ontario. In 1912 they sold just over 35,000,000 kilowatt hours; in 1926 the total sold exceeded 550,000,000 kilowatt hours, which yielded a revenue of £9,500,000.

These are astonishing figures. But other countries, particularly the United States and Norway, have made quite as remarkable strides as Canada has in the use of hydro-electricity. In Great Britain, also, progress has been made in the use of water power for generating electricity. England, Scotland, and Wales have been divided into a number of electricity districts, and the Electricity Supply Act of 1927 established a central authority—the Electricity Board. The industrial use of hydro-electric power is being rapidly

¹ *Essays and Treatises on Several Subjects* (1758), p. 174.

² *Principles of Political Economy and Taxation*, p. 49.

³ *Economics of Industry*, p. 87.

extended in the form of electrical heat, particularly in connection with the melting and treatment of various kinds of metals.

But natural resources are not inexhaustible. The tarns of Caledonia and of Snowdonia as sources of hydro-electric power are limited in number; the produce of the Welsh anthracite coalfields is gradually diminishing; the forests of Britain have almost disappeared, so much so that Government schemes of afforestation are becoming more and more prominent, and every effort is now being made to cultivate a "forest conscience."

Moreover, owing to differences in its physical and chemical composition, the fertility of the soil varies. Man can alter the character of the soil, and by scientific methods increase its fertility and economic efficiency, by irrigation, by the rotation of crops, by the use of chemicals, and by the destruction of insect pests. But despite such methods, and the assistance of more labour and more capital, the cultivator of a specific area will ultimately reach a maximum stage of fertility—a maximum output of produce—after which his returns for equal applications of labour and capital will get less and less. In other words, equal successive applications of labour and capital will result in continuously decreasing returns after the maximum output has been reached. This is termed the law of diminishing or non-proportional returns, a law of great importance to the producer.

Thus a stage is reached when the extra produce obtained, say in one year, from a certain amount of capital and labour expended on a certain area of land will not be equal to the extra produce obtained from an equal amount of capital and labour expended in the preceding year.

It is obvious that if cultivation is extended from a more fertile area to a less fertile, equal amounts of capital and labour expended on both areas will not produce equal returns; the produce of the more fertile land will be greater. We must

therefore distinguish between two types of cultivation, the intensive in a single area, and the extensive as the margin of cultivation is extended to less fertile areas. This subject of decreasing fertility will be returned to later when we discuss the theory of rent.

A great deal has been written about the problem of diminishing returns, not only with reference to the extractive industries such as mining and agriculture, but also in connection with manufactures. The problem is linked up with that of increasing population. Writers on population have been prominent in England since Tudor times. The beginning of English overseas expansion, which the Tudor and early Stuart periods witnessed, was due to some extent to the prevailing idea that England was over-populated, and the writers of the day were often haunted with the spectre of over-population.

But in Tudor and Stuart times over-population did not mean great density per square mile, for the population of England in the Elizabethan period was only about 5,000,000. By over-population the Tudor and Stuart writers simply meant that there were too many people in England in relation to the quantity of food which the country produced. In an age when periods of general scarcity were apt to recur with distressing frequency the problem was one of economic self-sufficiency. Over-population was gauged according to the number of bushels of English agricultural produce; the problem was an agricultural one based on returns from the soil.

Though eighteenth century writers like Gee¹ and Adam Smith favoured an increase of population, these views with reference to the bogey of over-population prevailed in England even after the great scientific development of English agriculture in the latter part of that century, when such remarkable progress was made with the cultivation of crops and the

¹ Joshua Gee was an English merchant and commercial writer whose publications appeared between 1725 and 1750.

breeding of animals for their meat. Towards the end of the century Thomas Robert Malthus¹ propounded what was termed "the principle of population," which, with a pretence to mathematical accuracy, was simply in essence an attempt to state more precisely what the Tudor and Stuart writers had in mind when they wrote about over-population. Indeed, some of his views on the problems of population were anticipated by that observant early Stuart writer Gerard de Malynes.²

Malthus in his treatise on the theory of population,³ compared the increase of annual produce with the increase of population. He thought that population when unchecked increased in geometrical ratio, and that the means of subsistence increased only in arithmetical progression.

This is the Malthusian theory of population, according to which population would double in twenty-five years, quadruple in fifty, and octuple in seventy-five, whereas the means of subsistence would only increase three times in fifty years and would take seventy-five years to quadruple. But Malthus did not foresee the opening of the great corn lands of North America and the Argentine, which, as Mr. L. L. Price remarks, "has brought the rich virgin soils of the New World to reinforce the more exhausted soils of the Old,"⁴ and though population has greatly increased since the beginning of the nineteenth century, there is no evidence to show that this increase has taken place every twenty-five years in the ratio he suggested. "The problem which Malthus thought he had solved," declares Professor Mantonx,⁵ "has remained unsolved to this day."

¹ Malthus (1766-1834) was Professor of History and Political Economy at Haileybury College from 1807 to 1834.

² Malynes was an early exponent of free trade. He wrote several treatises of which *Lex Mercatoria* (1622) is the most important.

³ Entitled *An Essay on the Principle of Population* (1798).

⁴ *A Short History of Political Economy in England* (twelfth ed., 1924), p. 51.

⁵ *The Industrial Revolution in the Eighteenth Century* (revised ed., 1927), p. 355.

Among the natural checks Malthus included moral restraint, vice, war, disease, famine, and he did not forget to emphasise unhealthy occupations, severe labour, bad nursing of children, and city life. In France, for instance, increase of population is very slow, chiefly owing to a particularly low birth rate. In some countries the death rate is needlessly high. This is the case in Roumania and Hungary where, in 1926, it was nearly 30 in the 1,000.

So far as England and Wales are concerned it has taken over a hundred years for the population to quadruple. In 1811 it was just over 10,000,000; in 1921 it was 37,885,000; and in 1930 it was estimated at nearly 40,000,000. There was a great deal of rural depopulation during the nineteenth century, and, as a result of the rapid industrial expansion, a constant migration to the big towns. This urbanisation of England constitutes a serious economic problem. In London, for example, the evils of overcrowding are appalling, and are a perpetual source of anxiety to the municipal authorities of the various Metropolitan boroughs. Stepney vividly illustrates this distressing congestion. There were in this district in 1927 about 280,000 people to 1,900 acres. Such congestion is accompanied by a high rate of infant mortality. Hence the importance of new housing schemes which are, with the aid of State subsidies, rapidly fructifying not only in the London area, where great changes have already been made, but also throughout Britain.

Other important British developments are the erection of garden cities such as Bournville and Port Sunlight; the settlement of ex-service men on the land; and the great encouragement and State aid now given to emigration, which has received an additional stimulus by the passing of the Empire Settlement Act in 1922 for furthering and assisting settlement in the British overseas dominions.

The problem of population leads us to the second agent of production, labour, for the quantity of labour is simply a

question of population. The earlier economists made a distinction between what they termed "productive" and "unproductive" labour. Services such as those of the actor, the doctor, or the notary, they regarded as "unproductive." The only "productive" labour was that expended on material objects. In fact, the Physiocrats, the well-known French economists of the latter part of the eighteenth century, regarded labour other than that devoted to agriculture as "sterile." Modern economists, however, regard all kinds of services as productive except, of course, those that are harmful to the good of a community. Thus the labours of the mechanic, the dustman, the doctor, and the errand-boy are all productive, while that of swindlers is unproductive and has been termed "predatory" labour.

Though the quantity of labour is entirely a matter of an increase or a decrease of population, its quality depends on many factors. The efficiency of labour is a result of physical strength, skill, intelligence, and adaptability, together with such important moral qualities as honesty, and trustworthiness. It is also obvious that the well-fed, well-clothed, well-housed, better educated, and better trained worker is more efficient than the ill-fed, ill-clothed, ill-housed, ill-educated, and ill-trained. The influence of home life, of surroundings, of climate, of earnings, of the duration of work, of family affection, and of outlook and prospects are also important efficiency factors.

Moreover, it must be remembered that though labour may be sometimes pleasurable, it is more frequently irksome and monotonous. A reduction of irksomeness by an increase of leisure adds to efficiency. Hence the numerous welfare schemes which are important features of many modern industries. "Human agents of production," remarks Marshall,¹ "are not bought and sold as machinery and other material agents of production are." Labour is perishable; the more

¹ *Economics of Industry*, p. 269.

skilled the worker the longer the time spent in training; the worker has to sell his labour, and this is often done under great disadvantages.

Finally, we must consider the mobility of, and the methods of applying labour. Some economists have distinguished various groups of labour. Cairnes, for example, gives four such groups.¹ The first includes the unskilled and nearly unskilled; the second, the artisans such as carpenters and smiths together with the small retail dealers; the third, the producers and dealers of a higher order such as civil engineers and chemists and the superior class of retail tradesmen; the fourth, persons "still more favourably circumstanced." Marshall distinguishes two broad groups,² the "hard-handed" and the soft-handed" industries, and Giddings four³: the "automatic" and the "responsible" manual labourers, and the "automatic" and the "responsible" brain workers. Professor Taussig gives five groups,⁴ but emphasises the fact that they gradually merge into one another. They are: (1) the lowest group, the "diggers and delvers" who depend on their physical strength; (2) those possessing some degree of specialisation such as motormen and factory operators whose work is comparatively simple; (3) the skilled workmen, such as carpenters and mechanics; (4) the lower middle class, such as clerks and small tradesmen; (5) the so-called "professional" class such as lawyers, physicians, and clergymen.

Whatever classification we adopt it is evident that the mobility of labour from one group to another is not very great. Nor is the mobility of labour from one industry to another

¹ *Some Leading Principles of Political Economy* (1884 ed.), pp. 66-7. John Elliot Cairnes (1823-75) was Professor of Political Economy in the University of Dublin from 1856 to 1865, and Professor of Political Economy in University College, London, from 1865 to 1872.

² *Principles of Economics*, p. 218.

³ *Political Science Quarterly*, Vol. II., pp. 69-71.

⁴ *Principles of Economics*, Vol. II., pp. 141-4.

a particularly great one, for labour tends to be localised. Hence, because of this general immobility, we speak of "frozen" labour.

Labour is applied in various ways. It may be purely manual, it may be used in connection with machinery, it may be used in private enterprise, it may be used in large scale production, the labourer may work alone or in co-operation with others, a man may be a specialist or a "jack of all trades." In modern industry, however, specialisation is the outstanding characteristic. Each worker has his own job, the work is divided in order to secure better co-operation. The complex nature of modern industry has intensified this specialisation or division of labour, though, of course, in its elementary form it is as old as family life, for man's first labour was that of hunting. Division of labour leads to economy of time and of tools, to quickness, dexterity, and adaptability. But, as is evident, it also has certain disadvantages. Its physical and mental effects are often injurious; its monotonous nature is apt to stifle initiative. Healthy surroundings, hygienic factories, increased leisure, humanitarian legislation, and welfare movements, have in recent years helped to mitigate these disadvantages.

But in addition to the division of labour among the various specialists, the division of processes, we often find labour concentrated in certain localities. This is what is termed the territorial division of labour, or the localisation of industry, of which there are some striking instances in Great Britain. Why, for example, is the English cotton industry concentrated in South Lancashire or the English porcelain industry in North Staffordshire? The reasons, of course, vary with the different localities. An industry may be attracted to a certain district because of some natural advantage, such as easy access to raw materials, or the possibilities of obtaining cheap power in the form of water or coal, or suitable climatic conditions. Other reasons may be the nearness of markets, the prospect of

establishing a new market, cheap labour, good transport facilities, and low rates, while in some cases there are historic reasons, such as the settlement in a particular district of alien craftsmen who have been compelled to leave their native land because of religious or political difficulties.

We must now briefly examine the nature of the third agent of production, capital. The term capital appears to have been first used by English writers in connection with accountancy, and in one of the earliest English treatises dealing with this subject, written by John Peele in Elizabethan times, it is used as equivalent to "stock."¹ Professor W. R. Scott tells us that the East India Company began in 1613 to call the sum invested by each shareholder in the company "capital."² Thus in the business of this great commercial corporation, and other such Stuart corporations, it came to mean a sum of money, and this is still the usual popular meaning.

The term capital was thus in use in England long before it appeared in a treatise dealing with economics. Adam Smith states that a person's capital is not identical with his stock, and he defines capital as that part of a man's stock from which he expects to derive an income. Smith classifies capital into "circulating" and "fixed." Modern economists regard circulating capital as that which serves its purpose by being used once, or, as John Stuart Mill states, "that which fulfils the whole of its office in the production in which it is engaged by a single use."³ Coal used as fuel, the wages of the workers, leather made into boots, steel made into a

¹ Peele, in his *Pathe waye to perfectnes in th' accomptes of Debitour and Creditour* (1569), uses the phrase "net substaunce, stocke or capitall." This appears to be the first example of the use of the economic term capital in a treatise written by an Englishman.

² *The Constitution and Finance of English, Scottish and Irish Joint Stock Companies* (1910-12), Vol. I., pp. 157-8.

³ *Principles of Political Economy* (seventh ed., 1871), Vol. I., p. 107. John Stuart Mill (1806-73) was the eldest son of James Mill. His *Principles*, first published in 1848, greatly influenced the writings of later nineteenth century economists.

safe, raw cotton converted into cotton cloth are examples of circulating capital.

Fixed capital, on the other hand, modern economists regard as durable capital, such as factories or machines, which can be used continuously, and from which returns are obtained over a period of time. Smith, however, distinguished between circulating and fixed capital from the standpoint of profit, whether or not the capital concerned yielded "a revenue or profit to its employer." His distinction is an interesting one, and is worth quoting.

"There are," he states,¹ "two different ways in which a capital may be employed so as to yield a revenue or profit to its employer. First, it may be employed in raising, manufacturing, or purchasing goods, and selling them again with a profit. The capital employed in this manner yields no revenue or profit to its employer, while it either remains in his possession, or continues in the same shape. The goods of the merchant yield him no revenue or profit till he sells them for money, and the money yields him as little till it is again changed for goods. His capital is continually going from him in one shape, and returning to him in another, and it is only by means of such circulation, or successive changes, that it can yield him any profit. Such capitals, therefore, may very properly be called circulating capitals. Secondly, it may be employed in the improvement of land, in the purchase of useful machines and instruments of trade, or in such-like things as yield a revenue or profit without changing masters, or circulating any further. Such capitals, therefore, may very properly be called fixed capitals."

Ricardo defined capital as "that part of the wealth of a country which is employed in production, and consists of food, clothing, tools, raw materials, machinery, etc., necessary to give effect to labour."² And this is a good definition of the

¹ *The Wealth of Nations* (Everyman's Library ed.), Vol. I., pp. 243-4.
² *Principles of Political Economy and Taxation*, pp. 93-4.

term, for capital is wealth which is used for producing more wealth. Thus, though we speak of the "capital market" and mean the money market, the market where loans can be obtained to start a business, capital includes a great many commodities other than money. It is likewise true that the head of a business when he refers to his "capital" usually means the sum of money or the total "stock" that is invested in the business and not his "stock" of tools, machinery or raw material. The economist, however, includes both the money "stock" and the "stock" that is used to produce new economic goods or commodities, that is, to create further wealth, under capital. But it must be remembered that the "stock" that is ready for sale, that is waiting for the "consumer" in a finished and enjoyable form, such as clothes, furniture, or loaves of bread, is not by some economists regarded as true capital, because it is not directly used in the production of new wealth.

We may therefore distinguish between "consumer's capital," i.e. the finished economic goods in an enjoyable form, and "producer's capital," such as raw material and plant, which is directly used in the process of production. Both forms constitute wealth, but, strictly speaking, only the second is true capital or "intermediary wealth."

This is the classification of capital adopted by Professor Taussig. Another classification, as we have just seen, is "fixed" and "circulating," and there are several others only the chief of which can be described here. Such are natural capital (land or nature power) and artificial (instruments made by man); trade capital (used in trade, such as a factory, raw material, the business man's own money, and loans) and social (belonging to the community, such as roads, the Post Office, state-owned railways); sunk capital (specialised capital used for one purpose such as the telephone, railway lines, and locomotives) and floating (capital fulfilling more than one function such as coal); remuneratory capital (the earnings

of labour) and auxiliary (all other forms such as raw material, plant, and money invested in a business); material capital (concrete goods used in production) and personal (skill, efficiency, and ability which cannot be transferred).

We must next consider how capital is accumulated. Fundamentally, of course, the accumulation of capital depends on labour and effort, on time, and on the will power to save. But there are other contributory factors, such as security, sound judgment, future needs, social ambition, and family affection. Obviously, much more capital is accumulated in a country possessing a stable government than in a country where there is constant social or political unrest. Then there are certain stimuli. In England, for instance, sound banks and thrift societies, and the National Savings Certificates are strong inducements to saving. Attractive rates of interest and a great demand for capital will also stimulate people to save.

Capital is more mobile than labour. It is not so easily hindered as labour is by barriers of language or of distance. Illustrations of this mobility constantly occur in the great money markets of the world, such as London and New York, where large loans are frequently obtained for productive enterprises in countries far away from the money market where the loan is raised. British capital has been used for the construction of great railways in India and in North and South America, docks in China, and dams in Egypt. The interest on loans of this nature are often a big source of income to the lending country.

All the capital needed in the process of production is composed of such "fixed" elements as factories, machinery, and tools, together with what may be termed "live" capital, or what the business man would call "live" assets, such as raw materials, intermediary products, outstanding accounts, and cash in hand. Capital is applied to business in certain organised ways. The business may be a private firm belonging

to a single person or a small number of partners, a large scale firm or joint stock company with thousands of shareholders, a municipal or State enterprise in which the rate-payers and tax-payers are particularly interested, or a co-operative concern run by the consumers whose profits depend on their personal purchases. These various types of business organisation will be described in more detail in the next two chapters.

The actual application of capital to business is the sphere of the fourth agent, organisation. The earlier economists, as we have seen, did not recognise this agent; they confined their attentions to land, labour, and capital. The remarkable development of modern industry and enterprise has caused more recent economists to add another agent. Thus, the chariot of production has been given four wheels: land, labour, capital, and organisation.

Organisation or management has to do with the technique and problems of industrial administration, with the governance of companies. It co-ordinates the other agents, and is thus the key to industrial prosperity. The paramount importance of skilful management to the life of a community is shown by the fact that in Great Britain alone there were in 1927 over 95,000 companies with a total paid up capital of over £4,470,000,000, and employing some 10,000,000 wage earners. Both Germany and the United States, however, are far ahead of Great Britain in the provision of instructional facilities in the principles of industrial administration. The British universities have been slow in developing facilities of this nature, and are only just beginning to realise the importance of the administrative faculty in business.

Other countries are also ahead of Great Britain with reference to the establishment of national associations for the study of the various methods of industrial management. The United States, for example, has its Management Association, which is a national body, and in France, Germany, Italy, Belgium, and other European countries there are national

associations of this kind. It is true that Great Britain has its Federation of British Industries, and its National Confederation of Employers' Organisations, but the functions of such bodies are different to those of a management association. "The object of a management association," states Mr. Seeborn Rowntree,¹ "is to study the art of management and the underlying sciences on which that art is based, to consider the different means of lowering production costs and of increasing efficiency, and to find out how to establish the right relations between Capital and Labour."

SUMMARY OF CHAPTER VI.

The four agents or factors of production are, as we have seen, land, labour, capital, organisation.

Land.—Includes not only the soil but also water, sunshine, and all the gifts of nature. In view of the great development of hydro-electricity water might be regarded as a separate agent.

In the cultivation of the soil the returns from equal applications of capital and labour begin to decrease after a maximum output is reached. This is what is termed the law of diminishing returns.

The problem of diminishing returns is linked up with that of population. Towards the end of the eighteenth century Malthus propounded his "principle of population." He stated that population when unchecked increased in geometrical ratio, and that the means of subsistence increased only in arithmetical progression. In the case of England and Wales it has taken over a hundred years for the population to quadruple. The overcrowding in the big English towns constitutes a serious economic problem.

Labour.—The earlier economists distinguished between—

(1) Productive labour expended on material objects. The Physiocrats regarded all labour other than that devoted to agriculture as sterile.

(2) Unproductive labour, e.g. the services of the doctor or actor.

Modern economists regard all kinds of services as productive except those that are actually harmful to a community.

¹ *The Contemporary Review*, November 1927.

The quantity of labour is a question of population. The quality of labour depends on skill, strength, intelligence, and adaptability.

Labour is perishable. The worker often sells his labour under great disadvantages.

The Mobility of Labour.—Labour may be classified into groups. The mobility from one group to another is not very great. Giddings divides the workers into four groups thus—

- (1) Automatic manual labourers.
- (2) Responsible manual labourers.
- (3) Automatic brain workers.
- (4) Responsible brain workers.

Taussig distinguishes five groups, Cairnes four, and Marshall two.

The Division of Labour.—Modern industry has intensified specialisation or the division of labour, which results in economy of time and of tools, and in quickness, dexterity, and adaptability.

But it may also result in severe physical and mental strain, and in stifling initiative.

The Localisation of Industry.—Industries may be concentrated in certain localities for various reasons, such as—

- (1) Natural advantages, e.g. climate, accessibility of raw materials or of power.
- (2) Accessibility of markets.
- (3) The prospecta of establishing new markets.
- (4) Cheap labour.
- (5) Good transport facilities.
- (6) Low rates.

Capital.—Adam Smith defines capital as that part of a man's stock from which he expects to derive an income. Ricardo states that capital is "that part of the wealth of a country which is employed in production," i.e. wealth that is used for the production of further wealth.

Taussig distinguishes between—

- (1) *Consumer's capital*, i.e. the finished economic goods in an enjoyable form, and
- (2) *Producer's capital*, such as raw material, and plant directly used in the process of production.

Adam Smith gives two types—

- (1) *Circulating capital*, such as the goods of a merchant which only yield a revenue when they are sold.

(2) *Fixed capital*, such as the machines and instruments of trade which yield a revenue without changing hands or circulating further.

There are various other classifications of capital such, for example, as—

- (1) *Natural*, i.e. land or nature power.
- (2) *Artificial*, instruments made by man.

The accumulation of capital depends on labour and effort, on time, on the will power to save, on a country's security, on sound judgment, on future needs, on social ambition, and on family affection, while saving is stimulated by banks and thrift societies, and attractive rates of interest.

The Mobility of Capital.—Capital is more mobile than labour. Loans, for example, raised in Great Britain have been used for constructive purposes all over the world.

Organisation.—Organisation or management has to do with the technique and problems of industrial administration, with the governance of companies. It is the business of the organiser or manager to co-ordinate the other agents of production.

CHAPTER VII.

THE PRODUCERS.

We have seen that income is derived from two big sources—labour and property—and that there are two great classes of income receivers—wage earners and capitalists. Both the wage earner and the capitalist are, of course, indispensable to production. The “automatic” and “responsible” wage earners labour to produce commodities; the capitalists invest their surplus income in business enterprises.

We may distinguish three main types of business enterprise. There is, first of all, the small scale business owned by a single person or a few partners, which operates under the most intensive competitive conditions, and whose existence depends entirely on the ability and initiative of its proprietor or proprietors.

Secondly, there are the businesses managed by public authorities. These are public concerns or public utility undertakings, and many of them are of great magnitude. In this class are included the big national businesses directly controlled by the Government such as the British Post Office, the Royal Mint, the Office of Works, and His Majesty's Stationery Office; national undertakings controlled by

officially appointed bodies such as the Central Electricity Board and the British Broadcasting Corporation; local undertakings managed directly by local authorities such as municipal gas and electricity works and tramways; local undertakings managed by specially appointed authorities such as the Port of London Authority, the Metropolitan Water Board, and the Mersey Docks and Harbour Board; and companies formed under the Building Societies Acts and under the Industrial and Provident Societies Acts, of which the Co-operative Wholesale and Retail Societies¹ established under the latter Acts are of outstanding importance.

Finally, there are the joint-stock companies which operate large scale businesses under boards of directors appointed by the shareholders.

Despite the dominant position of joint stock enterprise and the great development of public concerns the small business man still manages to hold his own. But the large-scale firm has certain important advantages in the economy of labour, material, and nature power which are not possessed by the small firm. The big business organisation can make a more efficient use of labour; it can find more regular employment for both its skilled and unskilled workers; it can purchase raw material on a more advantageous basis; it has more scope for the use of time-saving instruments; it can make much more use of the so-called "waste" material by developing by-products; it is able to devote much more money to advertising and research work.

It is therefore not surprising that such obvious advantages have in recent times resulted in a greater "rationalisation" of industry, by which is meant the organisation of industry into as large aggregations as are compatible with the maximum of economy in costs of production. Thus we find industries which are already big forming amalgamations, combines, and mergers. The bigger the amalgamation the greater is the

¹ The Co-operative Societies are described in Chap. VIII., *infra*.

concentration of production in the best-equipped works, the greater is the marketability of the shares, the greater are the advantages arising from the general pooling of experience and of brain power, the greater is the saving in overhead charges, the greater is the probability of weathering industrial storms and depressions, the greater is the command over capital.

On the other hand, "rationalisation" has certain disadvantages. An amalgamation may be so large as to become unwieldy; its size may be a handicap, and the personal touch between those in command and those in subordinate positions may be lost with consequent damage to the business. Amalgamations not infrequently result in staff reductions which cause much hardship, while the directors do not possess that intimate relationship with the consumer which the owner of a small business possesses.

But though big amalgamations effect great economies they do not always result in a lowering of prices. Cheaper production, which is rendered possible by the strength of an amalgamation, a large output, and up-to-date methods should, of course, mean a lower selling price, while still yielding reasonable profits. Investigators like Professor Macgregor and Mr. Cutforth have shown that in Britain big amalgamations are on the whole beneficial to the community, that the interests of the consumer do not suffer, and that they conduce to price stability. But it is true that there have been, especially in America, instances of powerful combines raising prices, and using unfair methods to crush rival firms in order to secure as complete a control as possible of the supply of a commodity. The aim of such combines is the securing of a monopoly by the elimination of competition, and the obtaining of excessive profits by exploiting the consumer.

Tendencies to monopoly in industrial enterprise therefore need our careful examination. Indeed, the methods of certain big American combines had become so dangerous to the general community that in 1890 the United States Govern-

ment passed the famous Sherman Anti-trust Act which forbade combinations in restraint of trade. This was followed in 1914 by two other anti-trust Acts, which declared "unfair methods of competition in commerce" to be illegal. The second of these later Acts—the Clayton Act—describes these unfair methods, such as the preventing by exclusive contracts of the buyers of commodities from dealing in the goods of rival firms; the practice of price discrimination, that is, the selling of commodities at different prices to different buyers; and the obtaining of favourable rates from the railway companies.

A monopoly may be a brief control of supply such as a "corner" in a wheat market, or it may be a control of supply for a lengthy period. Monopolies have been classified by economists in many ways. Professor Taussig, for instance, divides them into the absolute and the industrial.¹ The former either depend on legal protection, such as copyrights and patents, or are caused by the control of natural resources, a control which is very rare owing to the constant discovery of new sources. He gives as an example of the latter the control of the South African diamond mines. The industrial monopolies he classifies into public service industries and the so-called "trusts." Examples of the former of these are frequently found in modern municipalities, *e.g.* the public supply of electricity or of gas, and town corporation tramways, which, of course, so far as certain districts or urban areas are concerned, are absolute monopolies within these areas, just as a nationalised railway or the Post Office are absolute monopolies within the countries they serve. In the so-called "trusts" Professor Taussig includes all big industrial combines, mergers, or amalgamations which are powerful enough to influence prices.

The latter are included by another well-known American economist, Professor Ely, under the title of "complete

¹ *Principles of Economics*, Vol. II., pp. 113-18.

monopolies," which he defines as combinations which are able to fix prices by controlling over 75 per cent. but less than 100 per cent. of the supply of an article, while the control of 100 per cent. of the entire supply of a commodity or service, such as that of a single gas company which controls a town's supply of light, he regards as an "absolute" monopoly. Professor Ely, however, introduces a third class, the "partial" or "incomplete" monopoly in which he includes those combinations "which control so large a portion of the field of a particular business as to be able to restrain competition," and, therefore, as a result to make the conditions affecting the determination of price different to those prevailing under a régime of free competition.¹

The so-called "trusts" are of two kinds: an amalgamation of similar industries, such as the Standard Oil Company or the Imperial Tobacco Company; and an amalgamation of different industries. The former type is termed a "horizontal" combination, and the latter, in which all the individual industries usually contribute towards the production of the finished commodity, is the "vertical" combination, such as Dorman, Long & Co., which is primarily a great iron firm but has absorbed a number of collieries; or Palmer's Ship-building and Iron Company, a company which covers what has been termed "the whole field of production from pig-iron to battleships."

The identity of the individual firms in the merger may be preserved, each firm being allowed to trade under its old name as in the Imperial Tobacco Company, or it may be completely destroyed. The latter is the usual rule and is strikingly illustrated in the recent British railway and bank amalgamations. The names of the old railway companies which now comprise the four new groups have, with one exception, entirely disappeared. The London Midland and Scottish Railway Company, for example, is an amalgamation of eight

¹ *Monopolies and Trusts* (1900), pp. 76-7.

constituent companies, which include the old London and North Western, Midland, Caledonian, Glasgow and South Western, and Lancashire and Yorkshire, and twenty-seven subsidiary companies, which include the old North London, and the Maryport and Carlisle. In one railway amalgamation only, the Great Western, has the name of the absorbing company been retained. In the six big British bank amalgamations three of these powerful combines—Lloyds, Barclays, and the National Provincial—have retained the name of the absorbing company.

A "trust" has been defined by Mr. Maerosty as "originally a combination of a number of companies through a board of trustees to whom the shareholders assigned their shares in exchange for trust certificates."¹ The name "trust," however, is now applied to big combines that are not organised in this way. Thus when we speak of the "trustification" of industry we really mean the development of big amalgamations such as those that have just been discussed.

Indeed, the forms of industrial combination are far too varied to be examined in any detail in an introductory treatise of this nature. At the bottom of the scale is the simple agreement among a number of companies to adopt the same price. This is the price association. But the term "association" is often applied to a somewhat stronger, and more definite, type of combination not only for price-fixing purposes but also for the preservation of trade interests, and the arranging of the cheapest transport rates with railway and shipping companies. Such combinations are the British Tube Association, and the Small Iron Makers' Association. Moreover, the term "association" may be applied to an organisation for increasing the sales of a commodity such as the Durham Coal Sales Association. The last-named resembles the German "kartel," which is really an association of companies for regulating output, prices, and sales by means of

¹ *The Trust Movement in British Industry* (1907), p. 1.

a central committee or agency acting on behalf of each associated company.

Under the kartel arrangement each individual firm manages its own affairs. This type of German industrial organisation made remarkable progress in the two decades preceding the Great War; its aim was the stabilisation of prices. But since the war there has grown up in the kartel system a type of amalgamation with a greater degree of fusion, and this development has resulted in the establishment of "trusts" either by direct amalgamation or by "holding" companies, i.e. companies which are formed to acquire all or nearly all of the shares of the combining firms. In the first instance this new German development resulted in a number of "vertical" combines, but more recently the tendency has been towards the "horizontal" form of combination, particularly in the "heavy" industries, coal, iron, and steel, the finished marketable article, such as machinery, being constructed by a firm which is not in the combination. In 1926, for example, four big coal and iron groups which were themselves combines, were formed into a new powerful steel "trust," the Vereinigte Stahlwerke A.G., the largest on the continent.

Nor is this German "rationalisation" of industry confined to the iron and steel trade. The reconstruction of German industry since the Armistice has proceeded rapidly on these lines in other industries, such as locomotive and waggon building, shipping, shipbuilding, dyes, and potash. In shipping, the Hamburg-Amerika Line has recently absorbed the Deutsch-Austral and Kosmos Lines, while in the dye industry the two biggest combines have been absorbed in what is the largest of German "trusts," the I.G. Farbenindustrie A.G.

An interesting and valuable form of amalgamation for selling purposes, which has, since 1922, revolutionised the Canadian wheat trade, is the so-called wheat "pool." The

industrial depression which followed the war seriously affected the Canadian wheat farmers, so much so, that it became imperative to devise new methods of marketing their produce. As a result a system of co-operation was introduced which is known as the wheat "pool," and there is one such "pool" for each of the wheat growing provinces of Manitoba, Saskatchewan, and Alberta.

These "pools" or combinations of wheat farmers are governed by a board of management, which is the selling agency of the produce. The "pool" advances to the wheat farmer a sum of money, usually about \$1 a bushel, as soon as the crop is harvested, and such an advance, which, of course, does not represent the final market price of the wheat, immediately places the control of the wheat in the hands of the agency whose business is the marketing of the produce, and the making of additional payments to the farmer as the wheat is sold. The remarkable development of the Canadian wheat "pool" system is shown by the great increase in membership. In 1923 the "pools" possessed 70,000 members; in 1926 more than 126,000. In 1926 the "pools" sold 212,000,000 bushels of grain, which is over 70 per cent. of the total Canadian output of wheat, while in the same year their takings amounted to £54,300,000.

In Britain also, amalgamation has made remarkable progress in recent years. Bank combines have culminated in the "Big Six," Barclays, Lloyds, Martins, the Midland, the National Provincial, and the Westminster¹; railway amalgamation in the "Big Four," the London Midland and Scottish, London and North Eastern, Great Western, and Southern; and in the chemical industry there is what may be termed the "Big One," Imperial Chemical Industries Limited. This great chemical combine was formed at the close of 1926. It took under its wing the four most powerful chemical firms in

¹The British bank amalgamations are examined in more detail in Chap. XVII., *infra*.

Britain, Brunner, Mond & Co., Nobel Industries, the United Alkali Company, and the British Dyestuffs Corporation, a £65,000,000 combine, and within five months of its formation again expanded by absorbing the Cassel Cyanide Company, an old-established Glasgow firm.

Moreover, there are many instances of exceptionally big combinations in other British industries such as coal, iron, and steel, textiles, grain-milling, and the tobacco and liquor trades. A recent big coal merger was the amalgamation of two great Welsh companies, which were already powerful combines, the Amalgamated Anthracite Collieries Limited and the United Anthracite Collieries Limited, a merger authorised by the Railway and Canal Commission in June 1927. Such powerful amalgamations in the liquor trade as Bass-Worthington and Buchanan-Dewar are, of course, well-known. But a more novel merger of 1927 is, perhaps, not so well known. This is the amalgamation of two great building societies, the Halifax Permanent Building Society, and the Halifax Equitable Society. The former of these societies was at the time of the fusion the largest society of this type in the world, while the combined assets amounted to over £40,000,000, a remarkable sum, which proves that one of the outstanding economic effects of the post-war housing shortage in Britain has been a striking increase in that part of the savings of the workers which has been invested in building societies.

But the great land of "trusts" and huge combines is, as is well-known, America, where, as we have just seen, the evils of trustification became so pronounced that the United States Government was forced to intervene with special legislative measures. In the seventies of last century there were only four big industrial combinations in the United States; by the end of that century the number had increased to 185.

Though the holding company is still the usual form of trustification in America, the term "trust," here as elsewhere, includes all kinds of large scale amalgamations. The holding

company, however, is not regarded favourably by American law, particularly if it can be proved that such a company stifles competition. The great Standard Oil Trust, for example, operated from 1899 to 1911 under a holding company registered in New Jersey and termed the New Jersey Standard Oil Company, but under the Sherman Anti-trust Act the Supreme Court of the United States decided that this particular holding company was an illegal combination in restraint of trade. Hence the Standard Oil Trust is to-day simply a big merger of some thirty-six constituent companies.

The extraordinary development of big combines in the United States during recent years has been well described by Professor Bogart. "They control," he states,¹ "more or less successfully the production of tobacco, petroleum, sugar, linseed oil, iron and steel, copper, ship-building, beef, starch, flour, cotton-seed, candy, chewing gum, candles, salt, ice, glucose, crackers, matches, whiskey, anthracite coal, fertilisers, tin cans, farming tools, locomotives, writing paper, school furniture, sewer pipes, glassware, rubber goods, buttons, leather, and electrical supplies."

Such are the ways in which industrial enterprises are organised. We must next consider how the human factors engaged in industry organise themselves for the purpose of protecting their interests. On the one hand are the Employers' Associations, and on the other the Trade Unions of the employees.

An Employers' Association is, as its name implies, a body of the employers in a trade or their representatives. Primarily concerned with the interests of the owners, such a body must, of course, devote its attentions to all the factors, internal and external, affecting the trade as a whole. Sometimes it may be a group of local employers such as the Cumberland Coal Owners' Association, and sometimes a national body

¹ *Economic History of the United States*, (fourth ed. 1924), pp. 477-8.

such as the Association of British Chemical Manufacturers or the National Federation of Iron and Steel Manufacturers.

A Trade Union has been defined by Lord Passfield as "a continuous association of wage earners for the purpose of maintaining or improving the conditions of their working lives." Its business is, therefore, the uplifting of the worker, the improving of his standard of life, the reducing of the irksomeness of labour, the raising of wage rates, the assisting of the worker in times of unemployment and of sickness with friendly benefits, the protection of the worker from being unjustly treated, the encouraging and the developing of latent skill, the educating of the children of the workers and also of the workers themselves. In brief, a Trade Union looks after the interests of its members, and makes a point of possessing a thorough knowledge of the position and condition of the industry by which its members get their daily bread.

The striking nature of the real functions and widespread influence of a powerful and well-organised British Trade Union is clearly reflected in the annual reports of the National Union of Railwaymen. In June 1927, for example, Mr. Cramp, the industrial secretary of this great Union, reported that during 1926 large sums were paid to members in unemployment and part-time employment benefits, and that big grants were made out of the Union's four Benevolent Funds: (1) the Disablement Fund, (2) the Death and Orphans Fund, (3) the Accident Fund, (4) the Sick Fund. "The Union," it is rightly emphasised in this particular annual report, "has a legitimate pride in their Funds." Out of the Death and Orphans Fund, for instance, £43,577 was paid during 1926 in weekly allowances to 5,649 children, all of them fatherless and some also motherless; and since 1880 over £559,000 has been paid in this way on behalf of over 19,000 children. "The worth of a Union," Mr. Cramp very cogently states, "must be measured by the figures on the employers' pay-sheets, the lessening of hours, the prevention of accidents, the

remedying of wrongs, and the general upliftment of the lives of the workers."

The development of Trade Unionism in England during the last hundred years is a particularly interesting one. Lord Passfield and Mrs. Sidney Webb, in their *History of Trade Unionism*, have given us a detailed account of its progress. There is no doubt that trade clubs or unions existed in England in the eighteenth century and even earlier, and that despite the rigorous Combination Laws, which were in existence from 1799-1825, such clubs continued to flourish. This is proved by the references to these institutions in the evidence of various witnesses examined by the Royal Commissions and Select Committees of the first two decades of the nineteenth century.

When the Combination Laws were repealed the way was opened for the development of Trade Unionism, but it was not until the middle of the nineteenth century that the modern type of Union began to emerge. In 1851 the formation of the Amalgamated Society of Engineers gave the movement a new impetus, and some twenty years later a great deal of good constructive work was done by a central body of administrative officials known as the Junta. This body was composed of five able men¹ who, by their energy and initiative, contributed so largely to the placing of the movement on a particularly sound foundation.

Since the eighties of last century there have been some striking developments in British Trade Unionism. The movement received a powerful stimulus as a result of the great London Dock Strike of 1889, out of which "sprang an enthusiasm for Trade Unionism which, it is estimated, increased the total membership by about 200,000 within twelve months."² Amalgamation and federation have in recent years been outstanding features of the movement. The

¹ William Allan, Robert Applegarth, George Odger, Daniel Guile, and Edwin Coulson.

² J. F. Rees, *Social and Industrial History of England* (1920), p. 138.

National Union of Railwaymen, formed in 1913 out of three unions, is an important example of amalgamation, while among the federations the Miners' Federation, the Building Trades Federation, the National Federation of General Workers, the Engineering Trades Federation, and the Transport Workers' Federation are the most powerful.

The federations are of various types. The Miners', for instance, is an amalgamation of local Unions whose members are engaged in the coal industry, but the Building Trades Federation includes a number of national Unions whose members are engaged in different industries.

British Trade Unionism has also been unified and strengthened by the establishment in 1868 of a central body called the Trade Union Congress, which meets annually for discussing matters of general policy, and by the General Council set up in 1920. The latter body is composed of representatives from eighteen federations and amalgamations, and in 1924 was given by the Trade Union Congress the power to direct trade disputes.

In addition it must be noted that between 1870 and 1914 a number of legislative measures contributed towards the development of Trade Unionism in Great Britain. The most important of these measures are the Trade Union Act of 1871,¹ the Conspiracy and Protection of Property Act of 1875,² the Trade Union Amendment Act of 1876,³ the Trade Unions and Trade Disputes Act of 1906,⁴ and the Trade Union Act of 1913.⁵

The Act of 1871 declared that combinations in restraint of trade were not illegal. The Conspiracy and Protection of Property Act enacted that "an agreement or combination by two or more persons to do or procure to be done any act in furtherance of a trade dispute shall not be indictable as a

¹ 34 and 35 Vict. c. 31.

² 38 and 39 Vict. c. 86.

³ 39 and 40 Vict. c. 22.

⁴ 6 Edw. VII., c. 47.

⁵ 2 and 3 Geo. V., c. 30.

conspiracy if such act when committed by one person would not be criminally punishable."

The Act of 1876 defines a Trade Union as "any combination, whether temporary or permanent, for regulating the relations between workmen and masters, or between workmen and workmen, or between masters and masters, or for imposing restrictive conditions on the conduct of any trade or business, whether such combination would or would not, if the principal Act (i.e. the Act of 1871) had not been passed, have been deemed to have been an unlawful combination by reason of some one or more of its purposes being in restraint of trade."

The Act of 1906 allowed peaceful picketing, stipulated that "any act done in pursuance of an agreement or combination by two or more persons shall, if done in contemplation of a trade dispute, not be actionable unless the act, if done without any such agreement or combination, would be actionable," and prohibited actions of tort against trade unions.

The Act of 1913 gave a new definition of the term Trade Union, and dealt with the use of Union funds. A Trade Union is defined in this Act as "any combination, whether temporary or permanent, the principal objects of which are, under its constitution, statutory objects," which are explained as (1) the regulation of trade, and (2) the provision of benefit for members. This Act gave a Union power to use its funds for political purposes, and allowed members not willing to subscribe to a political levy to "contract out," i.e. to inform their secretary that they did not intend being subscribers to such a levy.

It will thus be seen that these legislative measures placed British Trade Unionism in a very powerful position by 1914, for the Acts of 1875 and 1906 had exempted the Unions from criminal and civil liability to which the ordinary person is subject.¹

¹ Chalmers and Asquith, *Outlines of Constitutional Law* (third ed., 1925) p. 37.

But though the legislative measures were favourable to the development of Unionism two judicial decisions in the early years of the present century caused a great deal of anxiety among the rapidly increasing members of the British Unions. These were the famous decisions in the Taff Vale (1901) and Osborne cases (1911).

The Taff Vale Case was the result of a strike of the employees of the Taff Vale Railway Company, the company being awarded £23,000 damages against the Amalgamated Society of Railway Servants, which had persuaded the employees to strike and thus break their contracts. A higher Court reversed this decision, but upon an appeal by the railway company to the House of Lords, the ruling of the first Court was upheld. The principles upheld in the Taff Vale judgment were set aside by the Act of 1906, which gave the Unions immunity from liability for civil wrongs, *i.e.* torts.

In the Osborne Case (*Amalgamated Society of Railway Servants v. Osborne*) the House of Lords decided that no Trade Union could legally demand from its members contributions to funds which were to be used for the purpose of paying Parliamentary representatives. This decision was followed by a great deal of agitation which ultimately resulted in the Act of 1913, which authorised the political levy.

Finally we must discuss the most recent legislative measure relating to British Trade Unionism, the Trade Disputes and Trade Unions Act of 1927,¹ a measure which was the outcome of the general strike of 1926.

Section 1 of this Act declares a strike illegal if it has any object other than or in addition to the furtherance of a trade dispute within the trade or industry, in which the strikers are engaged; and if it is designed or calculated to coerce the Government either directly or by inflicting hardship upon the community. An illegal lock-out is defined in similar terms. Section 2 provides that no person refusing to take part in an

¹ 17 and 18 Geo. V., c. 22.

illegal strike shall be subject to expulsion from any Trade Union or Society, or to any fine or penalty, or liable to be placed at any disadvantage as compared with other members of the Union or Society. Section 3 declares it to be unlawful for one or more persons to attend at or near a house or place where a person resides or works for the purpose of intimidating any person in that house or place. Section 4 provides that it shall not be lawful to require any member of a Trade Union to make any contribution to the political fund of a Union unless he has given notice, in a prescribed form, of his willingness to contribute thereto, i.e. unless he has "contracted in."

One of the remaining Sections of the Act defines a strike as "the cessation of work by a body of persons employed in any trade or industry acting in combination or a concerted refusal, or a refusal under a common understanding of any number of persons who are, or have been, so employed, to continue to work or to accept employment." A lock-out is defined in the same section as "the closing of a place of employment or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him in consequence of a dispute, done with a view to compelling those persons, or to aid another employer in compelling persons employed by him to accept terms or conditions of or affecting employment."

SUMMARY OF CHAPTER VII.

The Organisation of Industry.—Businesses may be classified into—

- (1) The small scale business.
- (2) The public concern which may be—
 - (a) A national business controlled directly by the Government.
 - (b) A national business controlled by an officially appointed body.
 - (c) A local undertaking controlled by a local authority.
 - (d) A local undertaking managed by a specially appointed authority.

(e) A company formed under the Building Societies Acts or under the Industrial and Provident Societies Acts.

(3) The joint stock company.

The Advantages and Disadvantages of Rationalisation.—A business may be organised on a small scale (the private firm), or on a large scale with a great number of shareholders.

The large scale firm is able to effect greater economies of labour, of material, and of power than the small firm. It has more scope for the use of time-saving instruments, and for the development of by-products, while it is able to devote much more money to advertising and research work.

Such advantages have resulted in bigger amalgamations, or, in other words, in a greater rationalisation of industry.

The bigger the amalgamation the greater is the concentration of production in the best equipped works, and the greater is the command over capital.

But there are certain disadvantages of rationalisation. The size of the amalgamation may be a handicap, the personal touch between the highest and the lowest workers may be lost.

The methods of certain big combines in America have resulted in the so-called "anti-trust" legislative measures such as the Sherman and Clayton Acts.

The Classification of Monopolies.—There are various classifications of monopolies. Taussig divides them into—

(1) *Absolute*, which either depend on legal protection, such as patents and copyrights, or on the control of natural resources.

(2) *Industrial*, which are subdivided into—(a) public service industries, such as town tramways, and (b) the so-called "trusts," in which are included all big industrial combines which are powerful enough to influence prices.

Ely, however, distinguishes three main classes of monopolies as follows :—

(1) *Absolute*, which control 100 per cent. of the supply of a commodity, e.g. a single gas company supplying a town.

(2) *Complete*, controlling over 75 per cent. but less than 100 per cent. of the supply, and therefore able to fix prices.

(3) *Partial*, those amalgamations "which control so large a portion of the field of a particular business as to be able to restrain competition."

Amalgamations of similar industries, such as the Imperial Tobacco Company, are termed "horizontal"; and amalgamations of different industries, such as Dorman, Long & Co., are termed "vertical."

Maerosty defines a trust as "originally a combination of a number of companies through a board of trustees to whom the shareholders assigned their shares in exchange for trust certificates." But the term "trust" is now applied to any big combine.

Forms of Industrial Amalgamation.—The forms of industrial combination vary from the price association to the big amalgamation. The following are interesting types :—

- (1) The Sales Association.
- (2) The German Kartel.
- (3) The Canadian Wheat Pool.

In British industry rationalisation has made great strides in recent years. Note, for example, the "Big Six" bank amalgamations, the "Big Four" railway groups, and the "Big One" in the chemical industry.

But the great land of big industrial combinations is America.

Employers Associations.—Though primarily concerned with the interests of the owners these bodies devote their attention to a trade as a whole. They are of two kinds, local and national.

Trade Unions.—The functions of a Trade Union may be summarised as follows :—

- (1) The improving of the worker's standard of life.
- (2) The reducing of the irksomeness of labour.
- (3) The raising of wage rates.
- (4) The assisting of the worker in times of unemployment and of sickness.
- (5) The protection of the worker from being unjustly treated.
- (6) The encouraging and the developing of latent skill.
- (7) The educating of the workers and their children.
- (8) The studying of the condition of the industry by which its members get their daily bread.

The repeal of the Combination Laws in 1825 prepared the way for the development of Trade Unionism in Great Britain. In 1851 the establishment of the Amalgamated Society of Engineers resulted in the formation of better organised Unions, and the work of the famous Junta in the

seventies of last century had far-reaching results. The numbers of Trade Unionists rapidly increased after the London Dock Strike of 1889. In recent years amalgamation and federation have been outstanding features.

British Trade Unionism has been strengthened by the establishment of the Trade Union Congress and the Trade Union General Council, while certain changes in the law between 1870 and 1914 were favourable to its development. The law, however, has recently been modified by the Trade Disputes and Trade Unions Act of 1927.

CHAPTER VIII.

THE PRODUCERS (*continued*).

"The development of association means rather that a new way of organising is being tried than that competition is being abandoned,"—D. H. Macgregor, *The Evolution of Industry*.

The amalgamation of industries which we have just discussed must be carefully distinguished from what is termed co-operation in industry. The term co-operation may be applied to the co-ordinating by a manager of different types of workers for productive purposes, which, as we have seen, is the dividing of the required labour among the various classes of wage earners employed in an industry, or in other words, the combining of the different human factors needed for the production of a commodity.

But when we speak of "the co-operative movement" we are referring to a form of co-operation of a different nature, and of which there are different varieties. A number of workers may, on their own initiative, co-operate in order to produce commodities, thus dispensing with the big employer or organiser; a number of tradesmen may co-operate for granting one another credit; a number of farmers may co-operate in order to strengthen their methods of marketing their produce or to improve their methods of cultivation; or a number of consumers may, in order to eliminate the profits of middlemen, co-operate for retail trading.

Of these latter kinds, co-operation in agriculture has not made much headway in a country of big landlords and com-

and co-operative stores quickly sprang up in all parts of the country.

There are, of course, a number of other causes which greatly assisted the development of the consumers' co-operative movement in Great Britain. The general improvement after 1850 in the condition of British wage earners gave it a great impetus. Between 1850 and 1870 the new railway system rapidly developed a national market, while British overseas trade was in a particularly prosperous condition. It was during these two decades—decades which Dr. Knowles has termed "the Good Years"¹—that the movement made very big strides under the guidance of middle-class wage earners of considerable ability and initiative.

A consumers' co-operative society was originally composed of members who eliminated the middleman by functioning as traders, selling at less than ordinary retail prices, and, after retaining a portion of the profits for the future needs of the business, sharing the remainder among themselves in accordance with the amount of their respective purchases. This, in essence, is still the function of such societies. But during "the Good Years" the movement developed a productive side. Wholesale societies were established for providing the retail stores with supplies on the same principle as the stores cater for their own members. In 1864 the English Co-operative Wholesale Society was established, and in 1868 the Scottish Co-operative Wholesale Society. These wholesale societies are really big producing companies possessing vast reserves, enormous factories, and wide sources of supply such as tea, cocoa, and sugar plantations. Their "members" are the various retail societies who share the profits of the wholesale society in the same way as their own members share their profits.

The consumers' co-operative movement has thus developed

¹ *Industrial and Commercial Revolutions in Great Britain during the Nineteenth Century*, (third ed., 1924), p. 111. -

big organisations of producers. There were in Great Britain in 1931 three wholesale and 1,188 retail co-operative societies, the latter possessing over six million members and a share and loan capital of over £142,000,000, and with their sales for the year amounting to £207,000,000 and their net surplus to £26,000,000. The average sales total of the retail societies for the five years 1927-31 amounted to over £210,000,000, and the average net surplus to over £25,000,000.

These figures show the extraordinary growth of the consumers' co-operative movement in Great Britain. But though the societies are of a capitalistic nature, and are now concerned with the production as well as the distribution of commodities, there are, however, certain limitations which make them a great deal different to the ordinary joint-stock company. In the co-operative society the profits are, as we have seen, shared in accordance with the amount of a member's purchases and not according to the amount of the shares held. In the co-operative society, also, the shares allowed to a co-operator are limited in number, and in shareholders' meetings each co-operator is allowed one vote only.

In the co-operative store prices are usually the prevailing market price, though occasionally the store price exceeds the market price in order to increase the dividends of the society. An expert witness told the British Food Prices Commission in 1925 that during the period of food control the co-operative societies were no gain to the working classes and no help in reducing prices. "They have," stated this witness, "a certain price for each and every article, which is as much as anywhere else in the town. If a customer thinks it is more than he should pay he is told that he will get it back in dividends. When co-operative societies started they served a good purpose. They sold goods at practically cost price, and not only reduced goods to their own customers but other trades had to come into line. Now the idea is to pay a big dividend which puts all competition on one side."

But though the co-operative movement may not be a factor in price reduction there is no doubt that it has given many wage earners a great deal of experience in organisation. The movement has also caused the demand for certain commodities to be far more regular, and this has resulted in a great reduction of waste ; it has been a big stimulus to thrift, for as Professor Taussig has remarked, " the stores not only make savings, they act also as savings banks."¹ In addition, great sums out of the profits have been devoted to educational projects, and the wholesale societies possess both banking and insurance departments.

Despite, however, most elaborate and detailed organisation, industry suffers from fluctuations, from ever-recurring periods of depression and serious unemployment. Business fluctuations are of various kinds. There may be monthly or even weekly variations, or there may be lengthy periods of prosperity followed by lengthy periods of depression. Fluctuations may occur very irregularly or fairly regularly in what are called " cycles." Sometimes trade depressions are so serious as to be termed commercial " crises."

Many theories have been advanced with reference to industrial fluctuations. The causes of a seasonal fluctuation in a specific industry such as the British coal trade experienced in the summer months, are, of course, evident. But the causes of the more widespread depression which covers many industries and which, during the nineteenth century, occurred at fairly regular intervals—the so-called trade " cycle"—are far from clear. Trade depressions may be due to an excessive expansion of output, to changes in the minds of business men, or to special disturbing factors such as war or bad harvests.

Much has been written by economists with reference to these periods of " boom " and of " slump." Professor Pigou, for example, emphasises as one of the causes of trade fluctua-

¹ *Principles of Economics*, Vol. II., p. 375.

tions, the changes in the minds of business men,¹ what he refers to as the swinging of business judgment "unduly towards optimism or towards pessimism."² This is the "psychological cause" of industrial fluctuations, and its importance is obvious when we consider the interdependence of trades and how quickly either pessimism or optimism can spread industrially. For as Mr. Henderson puts it, "a sympathy, subtle and intense, unites the business world, and a wave of depression or animation arising in any quarter may spread itself far and wide, heightened by the gusts of human hope and fear, and continue long after its influence is spent."³

Mr. Hawtrey, however, declares that the trade cycle is essentially "a monetary phenomenon," resulting from a contraction of what he terms "consumers' outlay" accompanied by reduced production.⁴

But whatever the real causes may be, trade depression results in serious unemployment. The depression, for instance, in British trade during recent years is reflected in the startling unemployment figures. The total number of insured persons registered as "wholly unemployed" at Employment Exchanges in Great Britain and Northern Ireland on April 24, 1933, exceeded 2,000,000.

In considering the problem of unemployment it will be observed that the figures vary considerably in different areas of a country and in different trades. In the British agricultural industry, for instance, there was no unemployment during the year 1927, whereas in the British pig iron, iron and steel, and tinplate trades, out of a total of 442 furnaces the number in blast at the end of July 1927 was only 174, figures which are striking evidence of a great deal of unemployment at this time in one or more of these particular trades.

¹ *Unemployment* (1913), Chap. VIII.; and *Industrial Fluctuations* (1927), Pt. I., Chap. V.

² *Industrial Fluctuations*, p. 51. ³ *Supply and Demand* (1922), p. 25.

⁴ *Quarterly Journal of Economics*, May 1927, p. 474.

These appalling British statistics relating to unemployment are, of course, to a large extent the disastrous result of the war. But though recent trade dislocation may be regarded as the product of the war, it must be remembered that the war has really only aggravated and not created the problem of unemployment. What then, apart from the industrial dislocation caused by war, are the causes of unemployment?

Professor Pigou states that "unemployment is wholly caused by the maladjustment between wage-rates and demand."¹ He thinks that wage-rates are inclined to be too rigid or, in other words, that they do not change often enough in accordance with the state of industry. If the demand for a commodity declines over a lengthy period, then the proprietors of the firms which supply this commodity cannot possibly pay their employees the old wage-rate, therefore the rate must either come down or a number of workers must be dispensed with.

On the other hand, Mr. J. M. Keynes suggests that unemployment is in part a problem of population, and he emphasises the fact that each year the young men ready to start their working life greatly exceed in number the old men leaving industry.² This brings us to the problems connected with the re-distribution of man-power, the problems of immigration and emigration, and of internal movements of population, which, so far as Great Britain is concerned, are to a great extent problems of Empire Settlement. Hence the passing of the British Empire Settlement Act in 1922 under which the Secretary of State for Dominion Affairs and for the Colonies can co-operate with the Government of any part of the Dominions, or with any public authorities or private organisations, for the purpose of carrying out schemes of Empire settlement. A special department in Whitehall, the Overseas Settlement Department, administers this Act. The financial contributions of the British Government to such

¹ *Unemployment*, p. 51.

² *The Times*, February, 16th 1923.

schemes must not exceed a total of £3,000,000 in any one year, all schemes being subject to the approval of the British Treasury.

A reduction of unemployment in a manufacturing country like Britain depends on increased orders for British goods, which, of course, can only be obtained when the prices of British goods compare favourably with the current prices in competing countries. The decline of exports, chiefly as a result of world-wide depression, and the consequent effect of this on the great industries associated with the export trade, such as the coal, engineering, shipbuilding, iron and steel, cotton and woollen industries, together with the heavy taxation which British industry has to bear, are two of the chief causes of the present very high British unemployment figures.

In attempting to analyse the problem of unemployment there are, however, several other factors to be considered. Thus, for example, seasonal and cyclical fluctuations in trade result in a surplus of labour, while a deficient industrial training of juveniles leads to a serious overcrowding among the ranks of the unskilled, or semi-skilled, workers. The invention of new machinery which dispenses with labour produces short-period unemployment, but in the long run, as production increases, new mechanical inventions decrease the volume of unemployment.¹

It follows, therefore, that some of the remedies for the disease of unemployment are : greater and cheaper production, a lessening of the burden of taxation, a better distribution of man-power, a better industrial training of juveniles, and a closer and more harmonious co-operation between labour and capital. Unemployment naturally leads to a great deal of social discontent, and it is of the utmost importance that every effort should be made to lessen the trials of the unemployed and to preserve industrial peace. Thus we find many countries

¹ Another important cause of unemployment—deflation—is examined in Chap. XVI, *infra*.

possessing special systems of social insurance, systems which have been greatly developed in recent years.

Germany was the first country to inaugurate the policy of compulsory state insurance for working men. This outstanding event in the history of social reform took place in 1883 during the remarkable period of industrial and commercial expansion which Germany experienced after the Franco-Prussian War, a great transition period in German industrial history which was, as in England several decades earlier, accompanied by a great deal of social unrest. The first German insurance measures were the Sickness and Insurance Bill, which became law in 1883; the Accident Insurance Bill, which was adopted by the Reichstag in 1884; and the Old Age and Invalidity Bill passed in 1889. "The whole matter," said Bismarck in supporting the second of these historic bills, "centres in the question, Is it the duty of the State, or is it not, to provide for its helpless citizens?" "I maintain," he added, "that it is the duty not only of the 'Christian State,' as I ventured once to call it when speaking of practical Christianity, but of every state."¹

From these beginnings the system of social insurance was not only rapidly developed in Germany but was also adopted by other countries. France, Austria, Belgium, Holland, Italy, Norway, Sweden, Denmark, Switzerland, the United States, Australia, New Zealand, and Great Britain now all possess well-developed systems of social insurance.

For lessening the trials of the unemployed a system of unemployment insurance has emerged, and in this development Great Britain led the world. Unemployment insurance was first introduced as an experiment confined to a specified number of trades, under the British National Insurance Act of 1911, since which date the British Government has rapidly developed it by a series of further legislative measures, the

¹ Quoted in Ogg and Sharp, *Economic Development of Modern Europe* (revised ed., 1926), p. 554.

most important of which is the Act of 1920. This Act extended the scheme to all persons of the age of 16 and upwards who are employed under a contract of service or apprenticeship, and all non-manual workers receiving less than £250 per annum, except persons in certain exempted employments such as agricultural workers, domestic servants, state and municipal employees, and most railway workers. When thus enlarged the scheme applied to a total of nearly 12,000,000 wage-earners; in the first instance in 1911 it applied to about 2,400,000.

Several changes have been made since 1920 in the working of the British system of unemployment insurance. Originally there were invariably three contributors, the employee, the employer, and the State, and unless the wage-earner regularly paid his contributions he became ineligible for any benefits when unemployed. More recent legislation has introduced the payment of what is termed "transitional benefit," which means that the registered worker may receive, after undergoing a "means test," a certain amount of unemployment "pay" when the "payments" he is entitled to have ended. The scheme has undoubtedly been the chief means of alleviating the great social distress which has accompanied a volume of unemployment unprecedented in the history of the British nation.¹

Unemployment insurance is, therefore, a powerful agent for promoting industrial peace. But in modern communities there are various other methods which conduce towards harmony in industry. The first essential of peace is the raising of the worker's standard of living by improving his welfare, by reducing the irksomeness of his labour, by making his surroundings more pleasant, by brightening his leisure hours, by increasing his educational facilities. Most employers now fully realise the paramount importance of increasing the happiness of the worker, and many big firms make a special feature of their educational and welfare schemes.

¹The scope of the Insurance Acts has been gradually extended in recent years.

The payment of the highest possible wage that the industry can bear is another important factor. This not only stimulates the worker but also unites employer and employee more closely, an alliance which is made still closer by allocating a share of the profits to the wage earners. Then there are various systems of sliding scales, in which wages may vary with the market price of the commodity produced; special piece rates and minimum rates under which the earnings are not allowed to fall; and various types of gain-sharing, such as bonuses on output or for economising materials, which must be distinguished from the actual sharing of profits. In fact, the term gain-sharing is also applied to the benefits that the workers derive from the various welfare schemes.

Profit-sharing is now a feature of many industries, but the method employed varies considerably. Sometimes half the profits of a business are set aside for distribution among the workers; sometimes a quarter; and sometimes a definite sum is allotted out of the profits to the employers and the remainder divided between the employers and the workers.

An interesting example of profit-sharing is that recently introduced by Messrs. Rowntree. In this scheme, after the ordinary wages have been paid to all types of workers, a fixed share of $7\frac{1}{2}$ per cent. goes to capital (i.e. the shareholders), and any surplus in certain agreed proportions. Before, however, the surplus is divided, 10 per cent. of it is set aside and added to the reserve. The remainder is then divided between labour, management, and capital, in the proportions of 50, 10, and 40 per cent. respectively. Thus the workers receive their normal wages plus 50 per cent. of any ultimate surplus, and the 50 per cent. is divided as an equal percentage on the actual earnings. Each worker's share of the surplus is paid into a bank from which it can be withdrawn, if the worker so desires, in cash.

In the preceding scheme the worker can receive his share of the profits in actual cash, and this is the usual method in

profit-sharing schemes. In addition, however, in Messrs. Rowntree's scheme, power is given to the directors to pay the worker his portion of the profits in shares. When this is done, of course, the worker becomes a shareholder or co-partner in the business, and the scheme then becomes a co-partnership one, a form of industrial co-operation which we have already examined.

Finally, in connection with the promotion of industrial peace we must consider the influence of conciliation and arbitration. A board of conciliation is made up of representatives of the employers and of the employees who meet in order to endeavour to settle any disputes in the trade with which they are concerned. In arbitration the dispute is referred to a third party, either a single arbitrator or a body of arbitrators. But even arbitration has not succeeded in abolishing strikes. Its disadvantages are obvious. There is, for instance, the great difficulty of securing an efficient chairman to preside impartially over a board of arbitration. Another difficulty is the enforcing of a decision against the wishes of a large number of workers. A guarantee to accept the decision of a board of arbitrators must necessarily be given by a few workers' delegates, and this guarantee might not be accepted by the main body.

Compulsory arbitration has been introduced in New Zealand and Australia, but in Great Britain both these methods of promoting industrial peace have, except during the war period, been entirely voluntary. There are, however, two British legislative measures appertaining to conciliation and arbitration, the Conciliation Act of 1896¹ and the Industrial Courts Act of 1919,² but both are based on the voluntary principle. Under the former Act the Board of Trade has power to set up an industrial board of conciliation upon receipt of a request for such from both employers and employees. The latter Act requires the Minister of Labour before referring

¹ 50 and 60 Vict. c. 30.

² 9 and 10 Geo. V., c. 69.

a dispute, with the consent of both parties, to the arbitration of the Industrial Court,¹ to satisfy himself that all methods of conciliation within the industry concerned have failed. This Act also empowers the Minister of Labour to set up a special court of enquiry to examine the facts of any dispute and to report. Numerous small disputes are dealt with annually by conciliation or arbitration. In 1931, for example, 96 disputes were settled under the Conciliation Act of 1896 and the Industrial Courts Act of 1906, and 13 by single arbitrators or boards of arbitration appointed by the Minister of Labour.

The Industrial Court must be carefully distinguished from another British institution, the Joint Industrial Council. During 1916-18 a special committee—the well-known Whitley Committee—set up by the British Government proposed the establishment of Joint Industrial Councils, in individual industries, composed of representatives of the employers and of the wage earners, who were to meet frequently for the consideration of such important topics as : the methods of fixing, paying, and re-adjusting wages ; the education of the workers ; the utilisation of the inventions of the workers ; industrial research ; the means of enabling the workers to benefit when the industry is experiencing a period of prosperity. The Whitley Committee also proposed the establishment of District Councils, and Workshop Committees, the latter to be set up in single firms. A number of such councils and committees have been set up. Before 1923 the Workshop Committees numbered over 1,000, and there is no doubt that good work has been done by some of these committees in promoting industrial peace.

But despite these various methods of arbitration and conciliation strikes and lock-outs still occur with serious effects. During 1926, for example, the number of disputes

¹ The Industrial Court is a standing court appointed by the Minister of Labour. It is composed of independent persons, representatives of employers, and representatives of employees.

involving stoppages of work in Great Britain and Northern Ireland reached a total of 320, a total which includes the most disastrous strike in the history of British industry—the general strike of May 1926, which involved more than 1,500,000 workers. It must be noted, however, that most of these strikes concerned only a small number of workers, and that though the actual number of strikes was the lowest since the year 1887, prior to which date no official statistics were collected, the total number of persons involved was far more numerous, and the total loss of time was far greater than in any of the preceding years. The 320 strikes during the year 1926 were ended in five ways: by direct negotiations between the parties or their representatives; by conciliation; by arbitration; by return to work on the employer's terms without negotiation; by the replacement of workers.

Among the causes of these strikes were wage questions, hours of labour and working arrangements, rules and discipline. By far the most important causes were the disputes about wages. This brings us to the great problem of the remuneration of the human factors engaged in industry, the problem of the sharing of income among the wage-earners and capitalists, which we must next examine.

SUMMARY OF CHAPTER VIII.

The Co-operative Movement.—The amalgamation of industries must be distinguished from the co-operative movement of which there are certain outstanding types such as—

- (1) Producers' co-operation.
- (2) Credit co-operation.
- (3) Agricultural co-operation.
- (4) Consumers' co-operation.

Producers' co-operation has not made much headway, but labour co-partnership, under which the wage earners acquire part ownership of the industry in which they are engaged, has made progress.

Credit co-operation has been well organised in Germany under the title of Schulze-Delitzsch and Raiffeisen Societies.

Agricultural co-operation has met with much success in Denmark, Germany, and the Irish Free State, but not in Great Britain.

Consumers' or distributive co-operation has made remarkable progress in Great Britain. This is due to—

(1) The lack of organisation among the small retail shops.

(2) The general improvement since 1850 of the British wage-earner's standard of living.

Each consumers' co-operative society shares its profits among its members.

During the "Good Years" (1850-1870) the British consumers' co-operative movement developed a productive side. In 1864 the English Co-operative Wholesale Society was established, and in 1868 the Scottish Co-operative Wholesale Society. These are now big producing companies possessing enormous factories, and wide sources of supply.

The consumers' co-operative societies have given the wage-earners a great deal of organising experience, while the establishment of such a large number of these societies in Great Britain has not only resulted in steadying the demand for certain commodities but also in a great reduction of waste. The movement has stimulated thrift, and large sums have been paid out of the profits for educational purposes.

Industrial Fluctuations and Unemployment.—The elaborate organisation of industry does not, however, prevent the recurrence of periods of depression and unemployment.

Trade fluctuations may occur fairly regularly in what are termed "trade cycles."

Among the causes of trade depression are war, bad harvests, and changes in the minds of business men.

Trade depressions aggravate the problem of unemployment. Pigou states that "unemployment is wholly caused by the maladjustment between wage-rates and demand." Keynes suggests that unemployment is in part a problem of population. A decrease in exports, and heavy taxation are two of the causes of the present high British unemployment figures. A deficient training of juveniles leads to overcrowding among the ranks of the unskilled. The invention of labour-saving machinery produces temporary unemployment.

Among the remedies of unemployment are: increased production, a better distribution of man power, a lessening of the burden of taxation, and a more harmonious co-operation between capital and labour.

Social Insurance.—For alleviating distress among the wage-earners many countries now possess systems of social insurance.

Germany was the first country to inaugurate compulsory State insurance, the first measure being the Sickness and Insurance Act of 1883.

Great Britain was the first country to introduce unemployment insurance. This was done under the National Insurance Act of 1911, and the system has been greatly extended under several Unemployment Insurance Acts, of which that of 1920 is the most important. A recent innovation is the payment of "transitional benefit," which means that the registered worker may receive, after undergoing a "means test," a certain amount of unemployment "pay" when the payments he is entitled to have ended.

Industrial Peace.—The chief methods of promoting industrial peace may be summarised as follows:—

- (1) Unemployment Insurance.
- (2) The raising of the workers' standard of living.
- (3) The payment of the highest possible wage that the industry can bear.
- (4) Sliding scales.
- (5) Gain-sharing.
- (6) Profit-sharing.
- (7) Labour co-partnership.
- (8) Conciliation and arbitration.

Conciliation and arbitration are important factors in the preservation of industrial peace. A board of conciliation is made up of representatives of the employers and of the employees. In arbitration the dispute is referred to a third party. Compulsory arbitration has been introduced in New Zealand and Australia.

There are two British legislative measures appertaining to conciliation which are based on voluntary principles. They are—

- (1) The Conciliation Act of 1896.
- (2) The Industrial Courts Act of 1919.

The Industrial Court, which is a court of arbitration, must be distinguished from the Joint Industrial Council of an individual industry, which is composed of representatives of the employers and the wage earners, and which meets for the purpose of discussing the problems of the industry concerned, such as the re-adjustment of wages, or the education of the employees.

CHAPTER IX.

THE INCOME SHARES: WAGES, PROFITS.

"Wages are paid because work is done. The value of the
is of the product, and the value of

"What is profit? At first sight this is a very simple question, which any small grocer can answer: it is the excess of selling price over cost price. But this simplicity is more apparent than real, for the exact determination of the specific income called 'profit' is, none the less, one of the most difficult and still one of the most discussed questions in economic science."—Gide, *Principles of Political Economy*.

The sharing or apportioning of income among workers and property owners is called by economists the distribution of wealth, and the income is, as we have seen, classified into wages, profits, rent, and interest. There is, of course, another meaning to the term distribution—the ordinary one. When we speak of the distribution of merchandise or newspapers we mean the forwarding of these commodities to widely scattered buyers, or, in other words, the passing of goods through the hands of wholesale and retail traders until they ultimately reach the consumer.

The term distribution was not applied to a department of economics until the early years of the nineteenth century when Boileau wrote his *Introduction to the Study of Political Economy*.¹ This treatise examines "the manner in which

¹ Published in 1811. Boileau's treatise is divided into four "books" entitled: (1) Nature and Origin of the Wealth of Nations; (2) Increase of the Wealth of Nations; (3) Of the Distribution of the Wealth of Nations; (4) Consumption of the Wealth of Nations.

the Wealth of Nations is produced increased, distributed, and consumed," and the third part is entitled, "Of the Distribution of the Wealth of Nations."

The earlier economists, as already stated, recognised only three income shares: wages, profits, rent. Adam Smith, for example, regarded income as divisible into what he terms the "wages of labour," the "profits of stock," and the "rent of land";¹ and this classification was adopted by Ricardo. They applied the term wages to the earnings of labour in the narrower sense, that is, to the earnings of manual labour, and it was not until John Stuart Mill introduced the phrase "wages of superintendence"² that the term labour received its broader meaning. The French economists, the Physiocrats, of the latter half of the eighteenth century, took for granted that the earnings of labour, in the narrower sense, always tended to be equivalent to an amount which just reached the bare means of living. If wages rose above this level, they said the population would increase until the increased supply of labour made the rate of wages fall again to the subsistence level.

This is the subsistence theory of wages, or, as it is sometimes termed, the iron or brazen law of wages. Even Ricardo thought that the supply of labourers was determined by a fixed and low standard of living, and that the labourers received in the long run the wages which such a low standard called for. But with the raising of the standard of living the subsistence theory gave way to what was known as the wages fund theory, which was a particularly popular one in the forties and fifties of the nineteenth century. This theory took for granted that there was a fixed "fund" of capital out of which wages were paid, and that any increase in the number of labourers would result in a decrease of their share of the fund.

¹ *Wealth of Nations* (Everyman's Library ed.), Vol. I., Chaps. VIII., IX., XI.

² *Principles of Political Economy*, Vol. I., p. 497.

Both James and John Stuart Mill were exponents of the wages fund theory, though the latter ultimately renounced it. "Universally, then, we may affirm, other things remaining the same," writes James Mill in explaining this doctrine, "that, if the ratio which capital and population bear to one another remains the same, wages will remain the same; if the ratio which capital bears to population increases, wages will rise."¹

By this James Mill meant that there was in a country at a certain time a definite amount of capital set apart for the payment of wages. Therefore, the amount received by each worker is determined by the number of the workers that is to say, wages depend on the ratio existing between the number of the workers and the wages fund.

It is, of course, true that if the supply of labour in a certain trade exceeds the demand the wages in that trade will tend to fall, but it does not necessarily follow that the more capital there is in a trade the higher wages will be. There is no special fixed "fund" predestined or deliberately set aside for the payment of wages.

Walker, the well-known American economist, was perhaps the greatest antagonist of the wages fund theory, though it had previously been attacked by several important British economists such as Richard Jones,² Cliffe Leslie,³ and Thornton.⁴ Walker emphatically rejected it, and in 1883 he introduced what is called the "residual claimant" theory of wages, in which he states that the worker's share of income is what remains after the recipients of rent, interest, and

¹ *Elements of Political Economy*, p. 28.

² Richard Jones (1790-1855) was Professor of Political Economy in King's College, London, from 1833-35; in 1835 he became Professor of Political Economy at Haileybury College.

³ Thomas Edward Cliffe Leslie (1827?-82) was Professor of Political Economy at Queen's College, Belfast, from 1853 to 1882.

⁴ William Thomas Thornton, C.B. (1813-80) was Secretary of Public Works in the India Office from 1858 to 1873.

profits have received their shares, that is, that the workers obtain the residual share. "These three shares," he tells us,¹ "being cut off the product of industry, the whole remaining body of wealth, daily or annually created, is the property of the labouring class; their wages, or the remuneration of their services."

But this theory—though not under the name that Walker gave it—had been enunciated by Jevons some four years earlier. "The wages of a working man," states Jevons,² "are ultimately coincident with what he produces after the deductions of rent, taxes, and the interest on capital." Sidgwick, also, a little later, was an exponent of this theory. "The remuneration of labour," he writes,³ "may be regarded as the share of produce that remains after paying for the use of capital and land."

In recent years economists have attempted to obtain greater precision in a theory of wages. The latest theories advocated are based on the actual output of the wage earners. These are the so-called "productivity" theories, one of which was first suggested by a German, von Thünen,⁴ who stated that wages tend to equal the extra produce raised by the last worker taken on by the employer. By the last worker he meant the "marginal" worker, the worker who is just on the point of not being employed.

In order to get at the basis of this particular theory it must, of course, be assumed that the workers are men of normal efficiency and employed under normal conditions. Why, let us say, does an employer employ 99 men and not 98? Because it just pays him to make use of the services of the ninety-ninth or marginal man; the engaging of the hundredth worker would mean a loss; the services of the hundredth worker

¹ *Political Economy*, pp. 250-1.

² *The Theory of Political Economy*, p. 292.

³ *Principles of Political Economy*, p. xlvii.

⁴ Johann Heinrich von Thünen (1783-1850), was a native of Oldenburg

would not be worth the wage which is offered, because his product would be worth less than his wage.

This is the marginal productivity theory of wages. Marshall illustrates it by taking the case of a farmer engaging a marginal shepherd.¹ The farmer calculates that the product of the marginal shepherd in one year will be twenty sheep, or, in other words, that the marginal shepherd "would do just so much in preventing the wastage of lambs and in other ways as will increase by twenty his annual output of sheep in good condition." The twenty sheep constitute the marginal product, or, as Marshall terms it, the "net product," which is the net addition which the marginal shepherd will make to the product of the other shepherds. Therefore the annual wage of the marginal shepherd tends to equal the market price of the twenty sheep, and is the annual wage of the other shepherds. In actual practice it will, of course, always be less than the market price of the sheep, probably a great deal less, so as to allow a share of the income to the farmer and to compensate him for providing the shepherd's wages before the sheep are sold.

The essence of this theory is that production takes time; that the wages of labour are advanced out of a surplus in the hands of a capitalist; that the person making the advance expects to receive for the product a sum which is more than that originally advanced as wages. Thus the wage earners receive as earnings a sum which is less than the market price of their product, and the wage rate is determined by the product of the marginal man who is regarded as the least efficient.

The most recent theories of wages are therefore based on the productivity of labour. Productivity, however, is an economic term which must be used with very great care. Strictly speaking, increased productivity means the increased joint productivity of labour and capital. Productivity, or produc-

¹ *Principles of Economics*, pp. 515-16.

tiveness, may be gauged by the amount of the output, or, in other words, by the bulk or volume, the size, weight or measurement of the produce, or by the value of the output as measured by market price. Wages, however, must necessarily depend on the market price of the product. The total amount paid in wages in a business is less than the total amount received for the product in a market because the employers of labour expect to receive a share of the returns as a reward for advancing the wages to the workers before any returns are received, and also because the employers themselves may have borrowed the money needed for such advances, and have therefore to pay back more than they originally obtained from the lenders.

It must be noted that there is at present a tendency among economists to avoid committing themselves to a particular theory and to confine their attentions to the explanation of how wages are determined under given conditions.¹ Wages are payments made to labour, and whether we refer to wages in a particular trade or to wages in general, it is evident that labour resembles other commodities in that its price depends primarily upon its demand and its supply. Thus in a particular trade like that of carpentering, if the supply of carpenters decreases, those that remain will probably be able to obtain a higher wage than they previously did, that is to say, a change in the supply of, or the demand for, carpenters will have a tendency to affect the wages of carpenters, though the general level of wages in other occupations may not be influenced.

Nor must it be forgotten that a combination of employers or of workers may temporarily influence the effects of changes in the supply of, or the demand for, labour. But Trade Unions cannot keep wages up indefinitely when trade con-

¹This is emphasised by L. Grier in "The Meaning of Wages," *Economic Journal*, December 1925.

ditions are adverse, nor can Employers' Associations keep wages down indefinitely when trade conditions are improving.

Moreover, minimum wage-rates in certain industries are now legally fixed in many countries, usually after an investigation into the conditions of the industry concerned has been made by a special body known as a Trade Board.

Trade Boards have been established for the express purpose of eliminating the evils of "sweating," by which is meant the exploitation of the poorer and less skilled workers by paying these workers exceptionally low wages. Before the first of the British Trade Board Acts became law in 1909, this exploitation was very evident in Great Britain in such trades as ready-made tailoring, lace-finishing, paper-boxmaking, and chain-making. It therefore became imperative to establish Boards—one for each such trade—whose duty was to investigate the conditions in these and other "sweated" trades, and to fix minimum rates of pay. These methods were extended by a second Trade Boards Act in 1918, and British Trade Boards can now not only fix a legal minimum wage but also various rates of pay such as overtime rates, though a beginning was made in this respect by the Act of 1909 which gave the boards power to fix piece rates. In addition, the Act of 1918 brought the better organised trades within the scope of the system.

Investigators have shown that in certain individual trades the increased rates of pay, fixed under the British Trade Boards system, have conduced to a greater efficiency among the workers, and have prevented sudden changes in the number of persons employed. On the other hand there have been complaints in some trades about the working of the system. The Government therefore appointed a Select Committee in 1921 to make a thorough investigation of its effects. The members of this committee, after listening to a great deal of evidence, came to the conclusion that there was "substance in the allegations that the operations of some of the Boards

have contributed to the volume of trade depression and unemployment." The committee, however, thought that the effect of the activities of Trade Boards upon British trade had "occasionally been stated in terms of exaggeration, because, unfortunately, many of the increased rates of pay fixed by the Boards commenced to operate when trade was actually decreasing, and that under such circumstances many employers were unable to adjust themselves to the changed conditions."

The final conclusion of the Select Committee was that the system had, on the whole, been a beneficial one because it was quite evident that the condition of the less skilled workers, both unorganised and organised, had been greatly improved, and that the Trade Boards had certainly succeeded in abolishing "the grosser forms of underpayment." The committee was also of opinion that the fairer or "good" type of employer, who was "able and willing to pay a reasonable rate of remuneration to his workers," had benefited under the system by being protected from the deliberate wage-cutting of unscrupulous competitors "prepared to take unfair advantage of the economic necessities of the workers."

Furthermore, the committee emphasised that the higher rates fixed by the boards had acted as "a stimulus to improvement in working methods"; that there were even instances of some piece-workers reaching their minimum wage without any increase in the actual piece rates paid; and that, generally speaking, the system had improved industrial relations, and had strengthened the organisation of both employers and employees.¹

It was thus found that the Trade Boards system caused a certain amount of economic friction. Consequently the Select Committee made a number of recommendations with reference to the fixing of minimum time and piece rates, and overtime rates based on these. The thirty-fourth and final

¹ *Report on the Working and Effects of the Trade Boards Acts, 1922* (Cmd. 1645).

commendation urges the repeal of the Trade Boards Acts, and the passing of a new Act including these recommendations. New legislation, however, has not yet appeared, therefore the Acts of 1909 and 1918 are still the British laws relating to Trade Boards.

But the Trade Boards system does not apply to the ill-paid British agricultural labourer. During the Great War, however, the British Government set up, under the Corn Production Act of 1917,¹ a central Agricultural Wages Board, and fixed a minimum wage of 25s. for agricultural workers, but the arrangement lapsed in 1921. Three difficult years passed before a new National Agricultural Wages Board was established under the Agricultural Wages Act of 1924,² an Act which also set up County Agricultural Wages Committees with power to fix minimum legal wages. The National Wages Board has no authority to revise the rates fixed by the local committees, but is allowed to fix a rate if requested to do so by the local committee or if this committee fails to fix a rate.

The fixing of wages by legislative methods has also been greatly developed in countries other than Great Britain. Australia, Austria, Canada, Czecho-Slovakia, France, Germany, Hungary, Italy, Norway, Roumania, South Africa, Uruguay, the Argentine Republic, and some of the States of the American Union have adopted various legislative measures for fixing wage rates, and systematically regulate minimum wages by means of either Trade Boards or what are termed "General" Boards.

But whereas the Trade Board is rigidly confined to a particular trade the General Board is allowed to fix minimum wage rates in a number of trades. General Boards are now functioning in the United States, in Canada, in South Africa, and in some of the States of the Australian Commonwealth. It is interesting to note that in more than one of the Australian

¹ 7 and 8 Geo. V., c. 46.

² 14 and 15 Geo. V., c. 37.

States three wage-fixing systems are operative—the Trade Board, the General Board, and the method of compulsory arbitration.

We must also distinguish the wage-fixing boards from such bodies as the Central and National Wages Boards which were set up under the British Railways Act of 1921.¹ These particular boards were constituted for arbitration purposes, and not for the purpose of fixing statutory wage rates. If in the case of a wage dispute no agreement is arrived at between the railway company and the Trade Union or Unions concerned, the matter is referred to the Central Wages Board, and on appeal to the National Wages Board. The former body is composed of eight representatives of the railway companies and eight representatives of the men; and the latter of six representatives of the companies, six of the men, and four of the users of the railways, together with an independent chairman appointed by the Ministry of Labour.

It is thus obvious that the circumstances affecting wage rates cannot be brought within the boundary of a single law or theory. The forces of competition may compel the worker to accept a very much lower wage than his "productiveness," or efficiency, demands. Then again, a basic wage-rate may be fixed by arbitration or conciliation, and this may be a time or a piece rate below which no wage is allowed to fall. And so also, there is the principle of the guaranteed week, which operates among British railway workers, and under which an employee receives his full week's pay, even if the railway company has not been able to find him a full week's work. Strong powers of bargaining among the workers invariably increase wage-rates; badly organised and casual workers have often to accept low wage-rates, and the rate in such cases is far below the marginal productivity of the worker as measured by the pecuniary worth of his output.

Among the preceding factors which affect the margin

¹ 11 and 12 Geo. V., c. 55.

between the actual wages received by the wage earners and the market price of the product, the forces of competition have, since the war, brought about great differences in the earnings of certain groups of workers. This is the great problem of wages in what are now known as the "unsheltered" and the "sheltered" industries, that is, those exposed to the full force of foreign competition like coalmining, and those not exposed to foreign competition like the railway industry.

In Britain, for example, the wages of all grades of workers in the "sheltered" industries are higher than the wages of similar grades of workers in the "unsheltered" industries, and it is not uncommon to find the earnings of unskilled "sheltered" workers higher than the earnings of skilled "unsheltered" workers. The reason for this is, of course, the lower costs of production in competing countries. The British unsheltered industries have to contend with the lower market prices prevailing in these countries, and therefore the wages in such industries tend to be lower than the wages in the industries that do not have to compete with rival foreign industries.

The problem is a serious one in Britain, and has resulted in a great deal of dissatisfaction among the workers employed in the "unsheltered" trades. But it is a problem appertaining to discrepancies in wage-rates, and differences of this nature must not be allowed to obscure such important questions as that of the living wage, and the wage that the trade can bear. By a living wage is meant something more than the bare subsistence wage of the older economists. Out of a living wage a worker should not only be able to maintain himself and his family in decency according to a certain standard of comfort, but should also be able to improve that standard.

But in thus defining the living wage we must not forget one important factor, and that is the size of the worker's family. It would, of course, be impossible in an industry to pay a man with a large family a higher rate than a man with a small

family. The wage, however, ought to be sufficient for a normal family of five, a man, his wife, and three children.

This in turn leads us to the question of family allowances. How can a man with more than three children be provided for, if a living wage is intended to cover the needs of a family of five? Certain schemes have been suggested. One of these is that an employer after paying a basic wage rate to all his workers should pay a certain sum weekly on behalf of each worker into a central fund or pool, and that the total should then be shared among the workers with families according to the numbers of the family.

The wage that the trade can bear is a problem which has given rise to a great deal of controversy. The employer, for instance, may claim that he has a right to decide what wage the trade can bear, after having first decided upon his own share of the returns. The workers, on the other hand, may insist that their wages should be a first charge on the industry in which they are employed. In this connection it has been suggested that an agreement should be made in advance specifying that the employer should retain a certain fixed percentage of the surplus takings, and that the remainder should be added to the workers' wages. One obvious difficulty, however, is the question of deciding the size of the reserve fund which an employer has to provide in case of future losses in the trade concerned, for the employer, who takes all the risk, must look much further ahead than the ordinary worker does.

In production, of course, the important problems are how to lower the cost of production per unit of the commodity produced and how, at the same time, to decrease the human costs, the efforts, fatigue, the monotony, the deadly routine of labour. Hence the enlightened employer is usually fully alive not only to the importance of a fair distribution of income among the workers but also to a fair distribution of leisure, to reducing the "pain-cost" of labour, to humanising the process of

production. The less the "pain-cost" of labour the greater is the efficiency of the wage-earner.

The employer's own share of the income of the industry he controls is usually termed "business profits," a phrase which admits, as we have already seen, of more than one explanation. Profit is the second of the great shares of income as originally distinguished by the earlier economists. It has been defined as a "mercantile margin," that is, the difference between the expenses of production and the market price of the product. But the term is not quite so easily explained because, in the first instance, we have got to decide what is meant by expenses of production.

Even so early as 1690, many decades before the time of Adam Smith, that keen economist Dr. Nicholas Barbon¹ attempted to analyse the meaning of the term profit. He pointed out that merchants in their trade expect in the price they receive for a commodity something which will be more than the interest they have to pay for a loan to help them in their business. This extra something over and above the rate of interest, which must cover bad debts and "bazarads," he termed gain, or profit.² Smith also uses the word hazard in connection with profit. He states that profit is obtained by capitalists because they "hazard their stock," and he appears to regard profit as a deduction from the produce of labour which the worker cannot prevent.³

A well-known early nineteenth century British economist, McCulloch,⁴ thought that there was no important difference between wages and profits. The former he regarded as the profits of "the proprietors of the machine called man exclusive

¹ 1648-1698. Barbon qualified for his M.D. at Utrecht.

² *Discourse of Trade* (1690), p. 32.

³ *Wealth of Nations*, Everyman's Library ed., Vol. I., p. 42.

⁴ John Ramsay McCulloch (1789-1864) was Professor of Political Economy at University College, London, from 1828-32.

of a sum to replace wear and tear"; the latter he defines as the wages of "accumulated labour," that is of capital.¹

But these economists wrote before industry was organised as it is to-day, before the co-ordination of specialists had become such a fine art, before the régime of the departmental system and of scientific management had become paramount. They did not foresee the rule of the salaried manager or director; they did not recognise organisation or management as an agent of production.

And it is this emergence of the paid organiser that makes the analysis of the term profits a somewhat difficult matter. Profits have been termed the "wages of management"; "business earnings"; "the reward of the entrepreneur, or undertaker, or enterpriser," the reward of the man who undertakes the hazards or risks of business. If the business has a paid manager or organiser, then the wages of management in this case are not profits but a reward for work done and are therefore earnings in the true sense of the word. Then again, if the owner of the enterprise is also the manager, he may regard what others term his profits as his wages for managing the business, and deem his services worthy of such wages, therefore there is not that "something over" which constitutes true profits.

Let us take a concrete example in order to make the reasoning a little clearer. Suppose X owns and manages a business which brings in £10,000 a year, the "expenses" of which amount to £9,000. What, then, may we term the sum of £1,000, which is the so-called "mercantile margin," the difference between his "expenses" and what he receives for the output? Ordinarily, of course, it would be termed "business profits." But X himself manages the business, therefore he naturally expects a remuneration for his work as manager. If he thinks that his services are worth £1,000 a

¹ *Principles of Political Economy* (1825), p. 319.

year, then the profit of the business is nil. On the other hand, let us suppose that *X* regards his services as worth £700 per annum. What, then, is the remaining £300? Part of it will represent interest on the money invested in the business. If, for example, *X* originally invested £5,000 in order to start the enterprise, and the market rate of interest for loanable capital is 5 per cent, then £250 represents interest on sunk capital, while the remaining £50 is the true profit or risk money, the "something over" to compensate him for the "hazards" of the business. Thus "business profits" may include: earnings, interest, and risk money or insurance.

Of course, in a big joint stock company where there may be more than one paid manager or director, the wages of these officials, which are fixed in advance of the marketing of the output, are included in the expenses of production in their correct place under salaries. Therefore the difference in this case between the actual monetary cost of production and the market price of the product would be made up of interest on the capital invested in the business plus a reward for risk, and this amount would be divided among the various shareholders in the form of dividends. If, say, at the end of the year the board of directors declared a dividend of 12 per cent., and at the time of this declaration the market rate of interest for loanable capital is 5 per cent., then the true or "net" business profits amount to 7 per cent. Hence the 12 per cent. may be regarded as "gross" profits, but in this case, however, there are only two elements: interest and risk money or insurance.

Thus, what in everyday language is referred to as "business profits," is really "gross" profits which includes elements other than risk money or the reward for "uncertainty-bearing."

This completes our brief examination of the terms wages and profits. We must next turn to the remaining big shares of income—rent and interest.

SUMMARY OF CHAPTER IX.

Distribution.—Distribution is the apportioning or sharing of income among the workers and the property owners. The income, as we have seen, is classified into wages, profits, rent, interest.

Wages.—There are three important theories of wages. They may thus be briefly described—

(1) *The Subsistence Theory* that wages tend to be equivalent to an amount which just covers the bare means of living. This theory prevailed in the early years of the nineteenth century.

(2) *The Wages Fund Theory* was very popular in the forties and fifties of the nineteenth century. According to this theory wages depend on the ratio which capital and population bear to one another. "If," states James Mill, "the ratio which capital bears to population increases, wages will rise."

(3) *The Residual Claimant Theory.* Walker, the American economist, was the great exponent of this theory. He declared that wages are the residue that go to the worker after the recipients of rent, interest, and profits have received their shares.

(4) *The Marginal Productivity Theory.* The supporters of this theory state that wages in an industry tend to be somewhat less than the market price of the product of the marginal worker. Production takes time. Wages are an advance payment out of a surplus in the hands of a capitalist. The person making the advance expects to receive for the product a sum which is more than that originally advanced as wages. Therefore the wage earners receive a sum which is less than the market price of their product. Productivity really means the joint productivity of labour and capital.

The tendency among the more recent economists is to avoid committing themselves to any particular theory of wages.

Trade Boards.—Trade Boards have been established in Great Britain for eliminating "sweating," and for fixing minimum wages. They first functioned in connection with such trades as ready-made tailoring and millinery, but have since been applied to several other trades. But these Boards do not apply to the British agricultural labourer, whose minimum wage rates are fixed by a National Wages Board and County Agricultural Wages Committees, which were set up in 1924.

The British Railwaymen possess Central and National Wages Boards

established under the Railway Act of 1921, but these are not wage-fixing boards.

The fixing of wages by legislative measures has also been greatly developed in countries other than Great Britain, such as France, Germany, the United States, New Zealand, Australia, and South Africa.

The "Sheltered" and "Unsheltered" Wage Rates.—Since the war the problem of wages has been complicated by the great differences in the rates paid to similar grades of workers in the "sheltered" industries, which are not exposed to foreign competition, and the "unsheltered," which get the full force of such competition.

The Living Wage.—This must be distinguished from the bare subsistence wage of the earlier economists. A living wage should enable a man to improve his standard of comfort.

Another important problem is the wage that the trade can bear. The workers may insist that their wages should be a first charge on industry. The employer may claim that his share of the returns should be decided upon before wages are considered. Moreover, there is the question of the size of the reserve fund.

Profits.—The employer's share is usually termed "business profits." But the employer must be distinguished from the paid manager or organiser. If, for instance, the employer is also the manager, then he may regard what others term his profits as his wages of management. If the business has a paid manager then his wages—i.e. the wages of management—are a reward for work done.

Profits are what remain after all expenses of production have been paid. They are a reward for risk, a compensation for the hazards of industrial enterprise.

CHAPTER X.

THE INCOME SHARES (*continued*): RENT, INTEREST.

"The income derived from the land and other free gifts of nature." —Marshall, *Economics of*

"Interest is the price paid for an independent and elementary factor of production which may be called either waiting or use of capital according to the point of view from which it is looked at."—G. Cassel, *The Nature and Necessity of Interest*.

The third of the great divisions of income is called rent. But in economics rent has a different meaning to the usual popular interpretation of this term. Take, for example, the so-called "rent" of a house. This goes to the owner of the house who is not necessarily the owner of the land upon which the house is built, and it represents interest on the money which the house-owner used in building the house. But the occupier may also have to pay what is termed "ground rent" which goes to the owner of the site. Thus the occupier may have to pay two separate "rents," "house rent" and "ground rent," or he may pay one sum called "rent," which includes these two "rents," to one person who is the owner of both the house and site. "The rent of a house (or other building)," writes Marshall,¹ "is a composite rent of which one part belongs to the site and the other to the buildings themselves."

Now let us suppose that Z pays £80 in "house rent" to one man and £10 in "ground rent" to another, and that Y, who is

¹ *Principles of Economics*, p. 453.

the occupier of a house equal in size to that occupied by Z and situated on an equal area of land, pays £100 in "house rent" and £14 in "ground rent." Why are Y's "rents" higher than Z's? These differences may, of course, be due to competition among "house hunters"; there may have been a larger number of applicants for the house occupied by Y, and as a result both the house owner and the ground landlord increased their respective rents. On the other hand, Y's rents may be higher than Z's because the house which Y occupies has more pleasant surroundings than that which Z occupies; it may be situated nearer a railway station, or more easily reached from the business part of the town; or it may be situated in a more modern or "superior" district. Therefore Y's higher rents may be due to differential advantages. A payment for a differential advantage of this nature is what the economist terms true or economic rent, which in Y's case amounts to £24.

These differences in what may be termed occupiers' rents are very evident in great cities, particularly so in the case of ground rents. The occupier of a shop in such a great shopping thoroughfare as New Bond Street, London, will have to pay a far bigger ground rent than the occupier of a similar sized shop on an equal area of ground in the Whitechapel Road, while the occupier of a shop in the Whitechapel Road will have to pay a higher ground rent than the occupier of a shop in a street in a small provincial town. In other words, economic rent in New Bond Street is far greater than in the Whitechapel Road. Similarly in an American sky-scraper the occupier of an office in the third storey pays a higher rent than the occupier of an office in the fifteenth storey, and here again the difference in the payments is economic rent.

In the preceding instances of urban sites economic rent is paid for advantages of situation. In New Bond Street it is paid for the superior business site; in the sky-scraper for easier accessibility. So also with agricultural land the

differential advantage may depend upon situation, such as nearness to a market, to a railway station, or to a dock. But in agricultural land there are also great differences in fertility, and under these circumstances rent will depend upon the differences in output. Thus economic rent may arise because of differences in fertility in different areas, or even because of such differences in a single area.

Let us examine the former case first. Suppose, for example, that there are three farmers of equal ability, Jones, Robinson, and Brown, who farm an equal number of acres of land, and who employ the same amount of labour and capital in cultivating their respective areas. Jones produces, say, 33 bushels of wheat to the acre; Robinson, 30 bushels; Brown, 25 bushels; while Brown's receipts for his produce just cover his expenses. Thus Jones has a surplus produce of 8 bushels per acre, and Robinson 5 bushels, which, of course, are surpluses over and above the produce per acre necessary to cover expenses. Such surpluses are economic rents due to differences in the fertility of the soil, and if Jones or Robinson let their farms they would expect as rent the money equivalent of the 8 or the 5 bushels per acre respectively. Brown is therefore the marginal farmer on the margin of cultivation.

With reference to the second case—the single area of land—we have already discussed the fact that equal applications of labour and capital to one particular area of land do not necessarily produce equal amounts of produce. Let us suppose that the fifteenth of an annual series of applications or “doses” of labour and capital results in a lesser return than the fourteenth which has produced the maximum output, and that the sixteenth results in a lesser return than the fifteenth, or, in other words, that the law of diminishing returns has set in. Now if the return from the sixteenth “dose” just pays the farmer, it is evident that the fourteenth and fifteenth “doses” have resulted in surpluses, and these surpluses are economic rents. Thus, as Professor Taussig has

stated, "rent arises because of differences in the amounts brought forth by equal quantities of labour."¹

The doctrine of economic rent, or, as it is sometimes called, the theory of surplus produce, was, in the first instance, in the days before the problem of urban sites in great cities became such a pressing one, applied only to agricultural land. It was in this connection that Ricardo emphasised the theory; hence it is often referred to as the Ricardian theory of rent. Moreover, it is a peculiarly British doctrine. In France it was, when first introduced little discussed, for France, unlike Britain, is not a land of big landlords. The theory, though known in England before the end of the eighteenth century,² was not very greatly discussed until the early years of the nineteenth. We find David Buchanan,³ for example, in the year before the battle of Waterloo, editing a new edition of the *Wealth of Nations*, in which he tries to explain the meaning of economic rent. "The profit of a monopoly," he states, "stands on precisely the same foundation as rent. A monopoly does artificially what in the case of rent is done by natural causes. It stint the supply of the market until the price rises above the level of wages and profits."⁴

Buchanan lived in an age of Parliamentary Inquiries and Reports about the high prices of corn, an age when, owing to the great increase of population and of wealth, the problem of increasing produce by recourse to inferior lands became of paramount importance. This naturally caused English economists to give a great deal of attention to these matters during the first three decades of the nineteenth century. It is therefore not surprising to find Malthus publishing a treatise in 1815 entitled *The Nature and Progress of Rent*, in which he

¹ *Principles of Economics*, Vol. II., p. 65.

² The theory of rent appears to have been first stated in 1777 by Dr. James Anderson in his *Enquiry into the Nature of the Corn Laws*.

³ Buchanan (1779-1848) was a native of Montrose.

⁴ Buchanan's edition of *The Wealth of Nations*, Vol. I., p. 99.

gives prominence to the law of diminishing returns, a law which was also, about the same time, emphasised by Sir Edward West.¹ "The principle," writes West, referring to diminishing returns, "is simply this, that in the progress of the improvement of cultivation, the raising of rude produce becomes progressively more expensive."²

Malthus disliked Buchanan's idea of the landlord as a monopolist, and in his *Nature and Progress of Rent* he gives us three reasons why rent is paid, one of which is that land produces more than enough to maintain its cultivators, and another that the most fertile land is comparatively scarce. These ideas were developed by Ricardo, who always regarded Malthus as the originator of the doctrine of rent. Ricardo defines rent as "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil."³ "It is," he adds, "only because land is of different qualities with respect to its productive powers, and because in the progress of population land of an inferior quality or less advantageously situated is called into cultivation, that rent is ever paid for the use of it."⁴

Thus originated the so-called Ricardian theory of rent. How the theory was extended by later nineteenth century economists will be described after we have examined the fourth of the shares of income, interest, a share which goes to the owner of capital.

The problem of interest is centuries old. "Love ye your enemies," advises the Book of Luke,⁵ "and do good, and lend, hoping for nothing again, and your reward shall be great." Plato forbade the taking of interest, and Aristotle regarded interest as unnatural because he thought that money was

¹ 1783-1828. West was appointed Recorder of Bombay in 1814 and Chief Justice in 1823.

² *An Essay on the Application of Capital to Land* (1815), p. 2.

³ *Principles of Political Economy and Taxation*, p. 49.

⁴ *Ibid.*, p. 54.

⁵ Chap. VI., verse 35.

"barren." The medieval church was severely antagonistic to the interest taker, or, as he was then known, the usurer. Usury was looked upon as a deadly sin. Gradually, however, in the thirteenth and fourteenth centuries people began to recognise two things: that the lender might easily suffer a loss during the period of a loan as a direct consequence of having given the use of his money to another person, and that a loss might easily be increased if the loan was not paid back on the day agreed upon. It was thus that the doctrine that usury was a sin began to break down, but it was not until 1545 that the taking of interest up to a maximum of 10 per cent. was first legalised in England.¹

Even after this outstanding event there was, despite the famous letter of Calvin some thirty years later, which did not condemn the taking of usury, and further Acts legalising interest, a great deal of discussion with reference to the problem of usury, a discussion which went on for many decades. But in Tudor and Stuart times usury had become a question of degree, of high rates or low rates, and if the money-lender's rate was not "biting," the taking of usury was not regarded as sinful. More than one of the later Stuart writers possessed a good grasp of the nature of interest. Sir William Petty, for instance, in a very valuable little treatise published in 1695, and entitled *Quantulumcumque Concerning Money*, defines interest, or "use-money" as he terms it, as "a reward for forbearing the use of your own money for a Term of Time agreed upon whatsoever need your self may have of it in the meanwhile."²

This quaintly-worded definition is, as we have already seen in our examination of the term capital, a good attempt to analyse the meaning of the term interest, for Sir William

¹ Under 37 Hen. VIII., c. 9.

² *Quantulumcumque Concerning Money*, p. 7. Sir William Petty (1623-87) was an outstanding seventeenth century economist and statistician.

recognises two important factors: forbearance and time. Even that great Victorian economist, John Stuart Mill, writing nearly two hundred years later, did not define interest so clearly. He states that it is "the remuneration for mere abstinence,"¹ a definition which, obviously, is not invariably true. It would, for instance, not be accurate to say that interest received by a big capitalist of the Rothschild type is the reward of sacrifice or abstinence. "The greatest accumulators of wealth," remarks Marshall,² "are very rich, some of whom live in luxury, and certainly do not practice abstinence in that sense of the term in which it is convertible with abstemiousness." But, on the other hand, it is quite true that from the standpoint of the small capitalist interest is to some extent, sometimes to a very great extent, a reward for sacrificing and abstaining, a reward for abstemiousness or the postponement of an enjoyment.

Interest, however, is primarily a reward for waiting. All capitalists, big or small, must wait for a return on their capital. "Capital," writes Nicholson,³ "is wealth set aside for the satisfaction—directly or indirectly—of future needs." Interest is paid because production takes time. The capitalist lends his money to a manufacturer thus giving the latter power to command at once labour and material with which, in time, he is able to produce a commodity which brings in more than he originally borrowed. Therefore the manufacturer, owing to the productivity of labour and capital, can afford to pay back to the capitalist somewhat more than he received. The borrower is, by means of the loan, able to hire services and purchase implements and raw material. He thus deprives the lender of the power to do this to the extent, of course, of the amount of the loan. Therefore the borrower pays interest for being given an immediate command over services and

¹ *Principles of Political Economy*, Vol. I., p. 496.

² *Economics of Industry*, p. 136.

³ *Principles of Political Economy* (1902), Vol. I., p. 91.

material, which he needs for a certain period, and also as a compensation to the lender who is not able to make use of the money advanced in this or any other way during the period of the loan.

Interest, then, is paid for the use of capital. We cannot, however, say that it is paid because capital by itself is productive, for, as has already been explained, capital separated from the other agents of production possesses no productivity. Interest is paid because labour, when applied in certain ways with the help of capital, is productive.

Furthermore, we may distinguish between what is termed "net" and "gross" interest. Net interest we may regard as "pure" interest; gross interest contains other elements. Let us assume that the rate paid by a British bank to its depositors is 3 per cent.; and that an East End money-lender's rate is 15 per cent. The bank, of course, pays its depositors for the loan of money, and as the risk in connection with the depositing of money in a British bank is almost negligible the 3 per cent. which the depositor receives may be regarded as "pure" or net interest, though, strictly speaking, it does contain a very small element which is a payment for the depositor's risk. In any case, the deposit rate of interest paid by one of the big British banks is as near as we can get to "pure" interest in "the ordinary business of life."

But the 15 per cent. charged by the East End money-lender partakes to some extent of the nature of risk money, though the money-lender himself would regard the whole of his charge as business profits, whereas, as a matter of fact, the greater part of it constitutes his own wages for managing a very difficult business. From the standpoint of the lender the 15 per cent. is gross profits, but from the standpoint of the borrower it is gross interest. Thus Sir William Petty had a very shrewd idea of the nature of usury when he analysed it into two elements: "a kind of insurance," and a "compensation for the inconvenience" which a man "admits against

himself" when he "giveth out his money upon condition that he may not demand it back again until a certain time to come whatever his necessities shall be in the meantime."¹

Such is the meaning of interest. We must next consider how the market rate of interest is determined. The high rates of interest obtained by professional money-lenders are, as we have just seen, due to exceptional circumstances, and contain a much lesser proportion of "pure" interest than of other elements. The market rate is always a little higher than the deposit rate of a bank, and it is, therefore, "gross" interest. Let us assume that it is 5 per cent. This means that for the loan of each £100 a borrower will have to pay £5. In other words, the 5 per cent. is the market price of loanable capital, and, like the prices of other commodities, it is fixed by the demand for, and the supply of, capital. Therefore we may say that, from the standpoint of demand, the market rate of interest depends on the marginal worth, utility, or "productivity" of capital, always remembering, of course, that when we speak of the productivity of capital we mean the joint productivity of capital and labour.

Thus capital is demanded because of its "productivity" or "productiveness," and the price paid for it, that is to say, the market rate of interest, will tend to be equivalent to the price paid for loans by the marginal or least productive businesses. If the least productive businesses can obtain the use of capital when they can only just afford to pay, say, 5 per cent. for it, the businesses which are more successful, and which could easily pay, say, 7 or 8 per cent., would not be prepared to pay a higher rate than 5 per cent.

We have already examined the causes which affect the supply of capital, and in this connection it must be noted that people will save money even if the rate of interest is zero. But despite this fact it may be safely stated that as a general rule an increase in the rate of interest will increase the amount of

¹ *Treatise of Taxes and Contributions* (1662), p. 29.

savings. Obviously, however, if capital is scarce, or if it is used for destructive purposes, as in war, the rate will rise. Then, again, an increase in population, new inventions involving expensive machinery, and an increase in the efficiency of the people, or in the intensity of their wants, will all result in an increase in the demand for capital and a consequent rise in the market rate of interest. It is also obvious that if one industry offers a higher rate of interest than another more capital will be attracted to this industry while the higher rate prevails, and that a bigger proportion of this higher rate than of the current market rate is a payment for risk. As Professor Taussig has aptly stated, the rate of interest depends upon the race between accumulation and improvement.¹

Finally, we must now return to the doctrine of economic rent in order to consider how the Ricardian theory has been extended by modern economists. Indeed, some of the later economists have been described as more Ricardian than Ricardo himself. Marshall, for instance, introduced the conception of quasi-rent, which he defines as "income from an appliance for production already made by man." The stock of such appliances he regarded as temporarily fixed; therefore for the time being, until similar appliances are produced they resemble land "of which the stock is permanently fixed and whose net income is true rent."² If in a period of trade activity a firm possesses a number of machines which cannot be immediately increased, it is quite evident that until the supply of such machines is increased, this particular firm will obtain bigger returns than those obtained under normal circumstances. The difference between the returns under these two conditions is termed quasi-rent, i.e. the excess returns over a short period which result from differential advantages.

¹ *Principles of Economics*, Vol. II., p. 32.

² *Economics of Industry*, p. 426.

Modern economists, also, have applied the doctrine of economic rent to wages, profits, and interest. In the case of wages not all workers have the same efficiency, ability, or strength. It may easily happen that of three men, Jones, Robinson, and Brown, employed in the same kind of work and earning equal wages, Robinson, through greater skill or strength, earns his wage with less effort than Brown, and that Jones uses still less effort than Robinson. Thus Jones and Robinson possess certain advantages over Brown which enable them to earn, by equal amounts of effort, more than Brown can earn for a like effort. That part of the earnings of Jones and of Robinson which is the result of such differential advantages is therefore economic rent, which is sometimes termed the "rent of ability." On the other hand, it is, of course, possible for workers to earn different wages for equal amounts of labour. The work of a West End theatrical star earning £300 a week is sometimes done by an understudy for, say £20 a week; the difference of £280 is really a rent, for the understudy does the necessary work with as much effort as the star.

Similarly in profits the element of rent appears, a characteristic which seems to have been first emphasised by Walker. It may happen that a number of firms engaged in the manufacture of a certain commodity do not obtain the same amount of profits on equal applications of capital and labour. The firm with the highest profits possesses certain advantages over the others such, for example, as a higher degree of efficiency, or easier accessibility to markets, and the difference in the profits constitutes a rent. "Starting," writes Walker,¹ "with a class of employers whom we call the no-profits employers, we have to note the indisputable fact that above these rise, rank on rank, employers of higher and still higher degrees of efficiency in the employment of labour and the conduct of business. These are men who have, by the force of education

¹ *First Lessons in Political Economy* (1890), p. 218.

or of experience, exceptional abilities or adaptations for commercial or industrial success. They are not always better men or better citizens than their less successful brethren ; but, from whatever source they derive it, they possess peculiar power in the production of wealth. Using the same amounts of labour and capital, they are able to produce more of wealth thereby."

In interest, however, the analysis is perhaps a little more difficult, and it introduces us to the conception of "saver's surplus." Let us assume that a rate of 5 per cent. is just enough to induce a saver, a postponer of present enjoyment, to make certain sacrifices in order to enable him to save £100, and that another saver would make equal sacrifices in order to save a like sum for 3 per cent. though he also obtains 5 per cent. The difference between the two rates of interest is a rent which goes to the saver who can save with less sacrifice than the other. The 5 per cent. man is therefore the marginal saver, and the 2 per cent. difference may be termed not only economic rent but also saver's or postponer's surplus.

SUMMARY OF CHAPTER X.

Rent.—The so-called rent of a house may be a composite rent ; it may include : (1) a payment to the house owner, which represents interest on the capital sunk in the building and which is sometimes called "house rent," and (2) a payment to the owner of the site, which is called "ground rent."

If in the case of two equal sized houses situated on equal areas of land the occupier of one house pays higher house and ground rents than the occupier of the other house, the difference is due to one or more advantages, such, for example, as a better situation. An extra payment of this nature for differential advantages is what the economist terms true or economic rent.

Such differences in ground rents are very evident in great cities where advantages of situation are of paramount importance.

In agricultural land economic rent varies because of differences in fertility.

If in the case of three farmers of equal ability, Jones, Robinson, and Brown, who farm an equal number of areas of land, the returns of wheat per acre are, say, Jones 33 bushels, Robinson 30, and Brown 25, then Jones has a surplus produce of 8 bushels per acre, and Robinson of 5. Such surpluses constitute economic rents, and are due to differences in fertility. Brown is the marginal farmer on the margin of cultivation.

The preceding illustration refers to extensive cultivation. But economic rent may arise in intensive cultivation, in a single area of land, because equal applications of capital and labour do not necessarily produce equal returns. Suppose, for example, that the fourteenth of an annual series of applications produces a maximum output, after which the law of diminishing returns begins to operate. Therefore the fifteenth application produces less than the fourteenth and the sixteenth less than the fifteenth. But if the return from the sixteenth just pays the farmer, the fourteenth and fifteenth applications have resulted in surpluses. These surpluses are economic rents.

The doctrine of economic rent, as originally applied to agricultural land, is peculiarly British. It has been attributed to Ricardo—hence the phrase “the Ricardian theory of rent”—but, in fact, was discussed by English economists before it was examined by Ricardo.

Interest.—The taking of interest, or usury as it was then called, was forbidden by the medieval church. It was not until 1545, when the maximum rate was fixed at 10 per cent., that English law first allowed the taking of interest.

Sir William Potty, in 1695, defined interest as “a reward for forbearing the use of your own money for a Term of Time agreed upon whatsoever need your self may have of it in the meanwhile.”

John Stuart Mill, writing in Victorian times, defines interest as “the remuneration for mere abstinence.”

Primarily, however, interest is a reward for waiting. All capitalists have to wait for a return on their capital.

Interest is paid because the borrower is given an immediate command over services and material. He therefore pays the lender a compensation because the latter is not able to make use of the money he advances during the period of the loan.

We must distinguish between “net” or “pure” interest and “gross” interest, which contains other elements. An East End money-lender’s interest, for example, contains other elements than “pure” interest. It includes a payment for risk, and his wages for managing a difficult business.

The market rate of interest depends on the demand for, and the supply of, capital.

How the Theory of Economic Rent has been Extended.—

(1) *Quasi-rent*: the surplus returns from “appliances made by man” obtained during a period of activity, when the supply of the appliances concerned cannot be immediately increased in number.

(2) Rent elements in wages, profits, and interest.

(a) *Wages*.—If one of two men, earning equal wages, earns his wage with less effort than the other he possesses an advantage over the other. The payment for this differential advantage partakes of the nature of rent.

(b) *Profits*.—It may happen that two firms engaged in the manufacture of a certain commodity do not obtain the same amount of profits on equal applications of capital and labour. The firm with the highest profits possesses certain advantages over the other and the difference in profits constitutes a rent.

(c) *Interest*.—If a rate of 5 per cent. is just enough to induce a man to make certain sacrifices to save £100, while a richer man who obtains the same rate makes less sacrifice than part of what the richer man obtains partakes of the nature of rent.

[A diagram illustrating the theory of economic rent appears in Appendix 2, *infra*.]

CHAPTER XI.

THE CONSUMERS.

"Consumption is not merely the art of eating: the word must be taken in a wider sense to cover the best possible use of the wealth that is available."—C. Gide, *Principles of Political Economy*.

To the economist "consuming" means the using of wealth, the using of raw materials for the creation of further wealth, and the satisfying of our desires with the finished commodities. Steel is consumed when a battleship is constructed: bread is consumed to appease hunger; a book is consumed when it is read. Thus the consumption of a commodity may take place quickly or slowly, while the commodities consumed vary in accordance with our wants and preferences.

The consumers are therefore the controllers of production, for it is upon their decisions that the supply of goods and services depends; their desires settle the total amount of the products, the size of what Mr. Hartley Withers terms the "wealth-heap." An increased demand for a commodity stimulates its production.

"Consumption," declares the author of the *Wealth of Nations*, "is the sole end and purpose of all production, and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer."¹ "A true theory of consumption," writes Neville Keynes,² "is the keystone of political economy."

¹ *Wealth of Nations* (Everyman's Library ed.), Vol. II., p. 155.

² *Scope and Method of Political Economy* (1891), p. 107.

But despite Adam Smith's declaration the earlier economists—with certain exceptions such as, Say, Boileau, and James Mill, whose treatises we have already referred to¹—did not pay much attention to the "theory of consumption," and it is only within the last three decades that this section of the "science of wealth" has secured greater prominence in economic treatises. Even so recent an economist as John Stuart Mill does not devote a single chapter to consumption in his well-known *Principles of Political Economy*, the seventh edition of which appeared in 1871.

The amount consumed by an individual depends primarily on income; the rich consume more than the poor. Individuals, however, even of the same social group, often differ greatly in the standard of their consumption; some are far more frugal than others. It may also happen that the supply of a commodity is very much in excess of the amount usually required by the consumers, that there is a large surplus in the hands of the sellers. This is what is generally termed "over-production," and it may be due to several causes, such as a wrong estimation of the potential demand, a sudden change in fashion, the appearance of a substitute, or defective organisation.

But "overproduction" is a term which needs careful examination. In modern industry it is not difficult by means of mass production to supply an article in such numbers as to cause a glut in the market. "Over-production" in this sense means that articles have been produced which can only be sold at a reduced profit, or at a loss. In the former case the so-called "over-production" results in the substitution of small profits for big; in the latter case it does not necessarily follow that the articles remain unsold; they may, for instance, be bought for purposes for which they were not originally intended, or sold in another type of market. Thus because of the extensiveness of human wants there is

¹ See pp. 39 and 92. *supra*.

really no such thing as "over-production" in the sense that an article cannot be used in some way or another, or that there is absolutely no market for it at any time or in any place. One of the earlier French economists maintained that the immediate remedy for a glut of one commodity is a big increase in the production of other commodities.

Several factors, therefore, may cause the sale of a commodity to fluctuate. Fundamentally, however, such fluctuations are due to changes in the wants of mankind, to changes of choice or of preference. Thus the foundation of a study of consumption and of consumers is a study of human choices or preferences, of the problem of choice-making.

This brings us to the problem of the "rational" man. Can we speak of a rational consumer? Does the ordinary man decide upon what he is going to consume without being in some way stimulated, influenced, assisted, guided, or even forced in his choice-making?

In the first place it must be recognised that the modern consumer is hemmed in by price-fixers, by rings of traders who agree beforehand to adhere rigidly to fixed price lists. Many commodities nowadays have a "ring" price; even the price of our daily bread is fixed by rings of millers and bakers.

In the second place we must remember that mass production has not only greatly affected the consumer from the standpoint of quantity but also from the standpoint of quality. This, of course, means that consumption is much more standardised in modern communities than it was a hundred years ago.

In the third place it is necessary to emphasise that variations and inequalities of income compel the consumer to make choices quite different from what he would like to make. The amount of the income is the dominating factor from the standpoint of the potential buyer.

Finally, both rich and poor consumers are constantly being influenced or guided in their choice by the highly developed

methods of the salesman and the advertiser in bringing to their notice the qualities and prices of commodities.

Salesmanship and advertising are powerful weapons in modern business, weapons which have far-reaching effects upon the choice-making of the consumer. "Without efficient salesmanship efficient production must fail to achieve its full and fitting reward. Selling is the end and aim of production. The work of the sales manager is the essential complement to that of the works manager; indeed, it is the condition precedent to his continued employment; for without markets the works of the country must cease to function."¹ Not only must the manufacturer produce the goods but he must also persuade the intending purchaser that they are just the commodities he wants. Manufacturers often establish contact with the consumer by the art of suggesting the use of a commodity, which the consumer may not even have thought of, and by constant reminders of its qualities. This means that in order to "nurse" the public, certain commodities are given a great amount of publicity.

But we have not exhausted the factors which affect the consumer in his choice-making. There are certain other influences which merit careful consideration. There is, for instance, what psychologists term "the herd instinct," or "group behaviour." The consumer often buys an article because other members of his class buy it. In addition, the consumer's choice may depend on his outlook, on his education, on his expectations, on his ignorance, and even on legislation. The last-named factor is well illustrated in the old sumptuary laws for checking excessive consumption, in the modern British licensing laws which compel a consumer to purchase alcoholic drink during certain periods regulated by law, and in the United States licensing laws of a few years ago which prohibited the purchase of alcoholic drink.

¹ Mr. F. W. Goodenough (Chairman of Barclays Bank) at the banquet of the Incorporated Sales Managers' Association, 21st February, 1928.

Legislative measures for regulating the consumption of commodities often have interesting economic results. Among the old sumptuary measures, many of which related to the regulation of apparel, the Tudor laws with reference to compulsory fish days, the first of which, passed in 1549, declared Fridays, Saturdays, the Ember days, Vigil days, and the period of Lent as fish eating days,¹ resulted not only in stimulating a Tudor key industry but also in raising the standard of English seamanship in an age of great maritime expansion, when an increase in the number of master mariners was one of the chief objects of national policy. Such legislation, however, as the British licensing laws may result in the consumer consuming more than he originally intended to, or less, or reducing his consumption to nil. The past rigorous licensing laws of the United States, already mentioned, resulted in a big smuggling trade, in "bootlegging" and its attendant evils.

State control of consumption was, of course, well in evidence in all the belligerent countries during the war. The Food Controller was paramount, food necessities were rigidly rationed, while a large number of diet substitutes made their appearance. The State, also, has in recent years increasingly protected the consumer against the adulteration of goods, the marketing of commodities under false names, and the sale of commodities that are harmful to health. Food inspectors and public analysts have rapidly increased in number, and food councils and committees keep a watchful eye on quality and on the trend of prices.

Furthermore, the consumer's choice-making is often greatly influenced by the system of instalment buying under which a consumer is able to fulfil a want immediately and pay for his satisfaction in instalments over a fairly lengthy period. In recent years instalment buying has made great progress in

¹ Cunningham, *Growth of English Industry and Commerce* (fifth ed., 1921-2), Vol. II., p. 68.

Great Britain and America. Its effects have been carefully investigated by American economists, who have come to the conclusion that, if the system is properly managed, it will develop into a particularly powerful stimulus to trade and to national wealth. Strictly speaking, there is no greater risk in consumer's credit than in producer's credit. The consumer benefits from instalment credit just in the same way as the manufacturer benefits from the credit granted him by a great commercial bank. "If instalment credit is restricted to proper commodities under proper management," declares Professor Seligman, "it will gradually throw off abuses and will stand forth as one of the most signal contributions of the twentieth century to the potential creation of national wealth and national welfare."¹

There is no doubt that instalment buying has become an indispensable part of modern trade. It is an inducement to thrift, for it makes the consumer exercise a careful control over his expenditure, and it benefits trade because certain commodities would not be widely purchased except under this system. A danger, however, arises when very long credits are given with minimum initial deposits, or shorter credits with no initial deposits.

The instalment system is safest when applied to the more durable type of commodities, for the commodities purchased under this system should outlast the instalments. It is also important that the consumer should carefully compare prices as in cash dealing, and not buy indiscriminately after agreeing upon the initial deposit and the number of instalments.

It is, therefore, quite evident that in modern communities choice-making is far from free. The consumer is subject to incessant stimuli which may, or may not, lead to wise consuming.

Wise consuming is a problem of luxuries and necessities. The latter we may divide into two kinds : commodities which

¹ *Financial Times*, November 21st, 1927.

are necessary for existence, the necessities of life; and commodities which are necessary for efficiency, the necessities of efficiency; while luxuries may be regarded as those commodities which are not indispensable to life or efficiency.

"Luxuries," states Sir Sydney Chapman,¹ "are things which when consumed do not appreciably add to, and may even detract from, a person's efficiency." "By necessities," remarks Adam Smith,² "I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even in the lowest order, to be without Under necessities, therefore, I comprehend not only those things which nature, but those things which the established rules of decency have rendered necessary to the lowest rank of people. All other things I call luxuries, without meaning by this appellation to throw the smallest degree of reproach upon the temperate use of them. Beer and ale, for example, in Great Britain, and wine, even in the wine countries, I call luxuries Nature does not render them necessary for the support of life, and custom nowhere renders it indecent to live without them."

The terms necessary and luxury are, however, relative terms. An article that was regarded in civilised communities as a luxury a hundred years ago may, as a result of the raising of the standard of life, now be deemed a necessary. Necessaries may depend on custom, on habit, or on climate. Marshall states that "some consumption of alcohol and tobacco," and "some indulgence in fashionable dress" are "conventionally necessary,"³ because in order to enjoy these indulgences the average individual is prepared to forego other articles which are necessary for efficiency. Thus we may distinguish a class of "conventional necessities."

¹ *Outlines of Political Economy*, p. 60.

² *The Wealth of Nations* (Everyman's Library ed.), Vol. I., pp. 351-2.

³ *Principles of Economics*, p. 70.

Spending on luxuries is sometimes regarded as "good for trade." It is true that such spending may give certain businesses a stimulus. But it must be remembered that the consumers of luxuries are making use of money which might easily be invested in industrial enterprise, and in this way provide work for more workers than the workers who are engaged in producing the luxuries. The short period results of spending on luxuries are far less beneficial to a community as a whole than the longer period results of investing the money in industry.

Wise consuming is therefore a question of wise spending. It is also a question of saving of which there may be more than one kind. We may satisfy our wants by consuming as little as possible of a commodity, reserving the remainder for another occasion; we may make a better use of so-called waste products; or we may defer our consumption of a commodity by completely sacrificing a present satisfaction for a greater one in the future. An illustration of the last case is, of course, the lending of money at a certain rate of interest, the lender denying himself the use of the money so lent for a period of time. Saving, however, must be carefully distinguished from hoarding. The hoarder of money simply withdraws it from circulation, therefore the amount withdrawn is not available for any purpose. It possesses no utility and from an economic standpoint is valueless. The saver also withdraws money from circulation when he deposits it in a bank, but such money does not lie dead like the hoarder's, for it is made use of by the bank in the form of loans to its customers.

The conditions which conduce towards saving have already been examined. The facilities for saving in modern communities are many. Apart from the ordinary banks, there are the big insurance companies; the various municipal and State loans; the shares of joint stock companies; the local and national savings institutions, such as the British Post

Office Savings Bank; the sale in most countries of premium bonds, and in Britain of savings certificates; the provident societies; and the building societies.

Finally, we must remember that, like the producers, the consumers have developed certain types of associations. The association or co-operation of consumers for retail trading, the consumers' co-operative movement, which has already been described, belongs really to the subject of production, for as Marshall states, this type is engaged in "economising effort in certain branches of business."¹ Another type is the association, such as a temperance or vegetarian society, whose members bind themselves not to consume a certain commodity, and who attempt by preaching and pamphleteering to convince others of the wisdom of their practices. Other types are those associations, societies, or leagues which aim at protecting the interests of the consumer in the sphere of markets and marketing by fighting high prices, by increasing or reducing tariffs, by eliminating adulterated food, and by reducing railway rates.

SUMMARY OF CHAPTER XI.

Consumption.—By consumption the economist means the using of raw materials for the purpose of production, and the actual enjoying or destroying of the finished commodities for directly satisfying our wants.

Over-Production.—An article is said to be over-produced when the supply is greatly in excess of the demand. If, however, there is a glut of a commodity in a market we cannot say that this is over-production in the sense that the commodity cannot possibly be sold. There is really no over-production in the sense that an article cannot be used in some way or another, or that there is absolutely no market for it at any time or in any place.

Choice-Making.—Fluctuations in the demand for a commodity are fundamentally due to changes of choice or of preference.

The foundation of a study of consumption is therefore a study of the

¹ *Principles of Economics*, p. 134.

problem of choice-making. In considering this problem it is necessary to remember that—

- (1) The modern consumer is hemmed in by rings of price fixers.
- (2) Consumption is more standardised than it was a hundred years ago.
- (3) Variations and inequalities of income compel the consumer to make choices quite different from what he would like to make.
- (4) The consumer is constantly influenced or guided in his choice-making by the salesman and the advertiser.

Furthermore, the consumer's choice may depend upon the choice of other members of his class, on his outlook, on his expectations, on his ignorance, on legislation, and on the system of instalment buying.

Luxuries and Necessaries.—Wise consuming is a problem of luxuries and necessities. Luxuries are commodities which are not indispensable to a person's efficiency, but an article that was a luxury a hundred years ago may, as a result of the raising of the standard of life, be now regarded as a necessary.

Marshall terms such a commodity as tobacco a "conventional necessary."

Spending on luxuries is not in the long run "good for trade."

Saving.—Wise consuming is also a question of saving. We may save in three ways :—

- (1) We may satisfy our wants by consuming as little as possible of a commodity, reserving the remainder for another occasion.
- (2) We may make a better use of the so-called waste products.
- (3) We may defer our consumption of a commodity by completely sacrificing a present satisfaction for a greater one in the future.

Consumers' Associations.—Consumers like producers have certain types of associations. In addition to the consumers' co-operative stores there are such associations as the temperance or vegetarian society, the society for fighting high prices, and the society for preserving the purity of food.

CHAPTER XII.

INTERNATIONAL TRADE.

"Sometimes trade itself has been the cause of war, but as the world grows older I think it grows wiser, and we are coming to realise that the prosperity of each country helps the prosperity of the others, and that none of us can find our own good fortune in the misfortune of another."—Sir Austen Chamberlain at the London Mansion House, February 20, 1928.

Trade between two countries arises because one country exporting a particular commodity possesses certain advantages over another country importing this commodity, advantages which result in lower costs of production. A commodity is exported because the exporting country is able to sell it at a lower price than the importing country, and this may be due to natural causes, to climatic conditions or resources, such as in the export of Brazilian coffee, China tea, Transvaal gold, British coal, Canadian timber, West Indian bananas, and American cotton; or to the superior initiative and ability of the producers, to the greater effectiveness of their labour, as in the case of English or American machinery.

Sometimes, however, we find a country importing a commodity which it can produce more cheaply than the exporting country. This is done because the importing country possesses far greater advantages than the exporting country in the production of another commodity than it does in the produc-

tion of the imported commodity, therefore, it is more profitable for the importing country to concentrate on the production of this other commodity.

Britain, for example, could, if it so desired, produce bacon cheaper than can the countries from which it receives this commodity, but as it possesses an enormous advantage over these other countries in the production of steel, it is far more profitable to Britain to concentrate on the production of the latter commodity. "France, for instance," states Professor Gide,¹ "can easily make motor-cars herself, and does make very fine ones, and agricultural machines likewise. But she cannot make them as economically as the United States, whose great factories are equipped for manufacturing them by the hundred thousand. In the same way England can supply France with ships, and Germany can provide her with chemical products and dye-stuffs, more cheaply than France can manufacture these things herself." Countries, therefore, tend to concentrate on the production of commodities in which they possess the greatest advantages, the greatest effectiveness of labour, the greatest "economy of labour."

Let us take, for example, two countries, Y and Z, under conditions of free marketing, and wheat and cloth as two commodities in which they trade. Now if we assume that Z produces wheat at 10s. a bushel and cloth at 5s. a yard, and that Y produces wheat at 20s. per bushel and cloth at 10s. a yard, it will be observed that Z possesses an advantage in both these commodities. But in both instances the advantage is the same, the ratios (1 to 2) between the costs of production are identical or, in other words, comparative costs are equal, therefore, though it is possible that a small trade may arise it will not last long. There can be no permanent trade between Y and Z, because Z with its lower costs of production will export both wheat and cloth to Y, and, sooner or later, as a result of the influx of money into Z prices will begin to rise

¹ *Principles of Political Economy* (1924 ed.), p. 250.

in this country and fall in Y ¹ until alternately the costs of production of wheat and cloth in both countries will be equal. But if, in the first instance, the ratios between the costs of production of wheat and cloth are not equal, then a permanent trade will arise between Y and Z . If, for example, Z produces wheat at 10s. a bushel and cloth at 5s. a yard, and Y produces wheat at 18s. a bushel and cloth at 7s. a yard comparative costs differ, and Z possessing an advantage in both commodities will immediately commence to export wheat and cloth. Here again the result will be that, as the exports of both commodities from Z increase and the transference of money from Y to Z continues, the cost of production of both wheat and cloth will gradually increase in Z and decrease in Y until wheat will cost, say, 12s. a bushel in Z and 16s. in Y , and cloth 6s. a yard in both countries. Therefore cost of producing cloth being now equal in both countries, and Z still having a lower cost of production in wheat, Z will commence to concentrate on the export of wheat, a concentration which will result in the trade in wheat between the two countries becoming permanent. Y , on the other hand, will gradually reduce its production of wheat and become more and more dependent on Z for its supplies.

This is what economists term the theory of international trade, or of comparative costs. But it must be emphasised that the principles of international trade do not differ from those of internal trade. The law of comparative costs applies to trade between county and county just the same as between country and country. "The rule of comparative cost," declares Professor Bastable,² "includes and explains by far the largest part of foreign commerce, and so far from being a strained or unnatural application of theory, is in reality only the form that the general condition of exchange between

¹ For a more detailed examination of the effect on prices of an increase in the quantity of money is given in Chap. XVI., *infra*.

² *Commerce of Nations* (eighth ed., 1917), p. 10.

separate persons or distinct groups assumes when applied to countries whose system of internal exchanges is regulated by cost of production." In practice, however, the commerce of nations has to contend with many barriers, and though some Governments allow a freer trade than others, most of the countries of the world have a very complete system of high tariffs for the purpose of keeping out the goods of importing countries.

Protection is a commercial policy in which the trade of a nation is strictly regulated in its own interests. It is a nationalist system under which a country becomes individualistic, and aims at economic independence by the encouragement of home industries and the placing of restraint on foreign trade. It is a system under which national frontiers become economic frontiers.

The advocates of protection give many reasons, both political and economic, in its favour. Perhaps the most powerful economic argument is that new or "infant" native industries need to be carefully shielded from foreign competition. Such industries, it is argued, are delicate and easily stifled, and have to contend with many difficulties in their earliest years, therefore until they are firmly established they must be rigidly protected from the devastating competition of like external industries by a State bounty or subsidy, or by a duty on the importation of rival commodities. These, state the protectionists, are the only ways in which "infant" industries can be nurtured.

From the "infant" industry reason is but a short step to the argument that a protective system increases a nation's productive power, which, in turn, leads to an increase of employment and an influx of labour and capital. In addition, the protectionists assert that their system lowers prices by increasing home competition, that it raises wages, that import duties are a big source of revenue because they are paid by the foreign producer, that it results in a steady market, and

that it prevents a certain special kind of foreign competition which is termed "dumping."

All these arguments in favour of protection are, of course, contested by the free traders who claim that "infant" industries, except perhaps in isolated cases, can thrive without State assistance, and that restrictions on trade do not tend to lower prices and raise wages, or even conduce to steadiness in trade. It is true that custom duties are not as a rule paid by the foreign producer. The incidence of such taxes is a far too complicated problem to enter into here. But we may safely say that taxes on imported goods do not fall on the foreign producer except in very rare instances, such as when there is no other market for the article imported, or when the demand for it in the importing country is so small that a restriction of the supply will not raise its price.

With reference to dumping, however, there are grounds for a policy of restriction. Dumping by a foreign producer is sometimes part of a deliberate policy to capture a country's home market; although the commodities dumped may be genuine surpluses, they are very frequently specially produced in order to dominate the trade in a certain commodity in the importing country, and in this way to reduce competition. The motives of a country that dumps are therefore usually of a destructive nature so far as the trade of the buying country is concerned, for the dumped goods are sold at prices which make it impossible for the home producers to compete. The aim of external manufacturers who adopt this policy is the monopolistic control of markets and the ultimate control of prices.

Indeed, the problem of dumping became so serious in Britain just after the war that the British Government was compelled to introduce a policy of tariff protection by passing the Safeguarding of Industries Act in 1921, an Act, however, which did not become law until over four years had been given to a careful consideration of this problem. The Com-

mitted on Commercial and Industrial Policy after the War, which the British Government set up under the chairmanship of Lord Balfour of Burleigh, recommended in its Report issued to the public in 1918 that "some Governmental action should be taken to promote and safeguard the development in the United Kingdom of industries of a special or pivotal character," and emphasised that British producers were entitled to receive protection from the Government against dumping in the home market.¹

The scope of the Safeguarding of Industries Act is quite evident from its title which reads thus: "An Act to impose duties of customs on certain goods with a view to the safeguarding of certain special industries and the safeguarding of employment in industries in the United Kingdom against the effects of the depreciation of foreign currencies, and the disposal of imported goods at prices below the cost of production, and for purposes connected therewith."

Part I. of the Safeguarding of Industries Act is devoted to the safeguarding of what are termed "key industries." A list of these industries is given in a schedule attached to the Act, and a customs duty, equal to "one-third of the value of the goods," is imposed on all the commodities mentioned in this list if they are imported from any part of the world except the British Empire. The goods chargeable with this duty include optical glass and optical elements; beakers, flasks, and crucibles; galvanometers, electroscopes and barometers; wireless valves and similar rectifiers; ignition magnetos and permanent magnets; arc-lamp carbons; all synthetic organic chemicals (other than synthetic organic dyestuffs, colours, and colouring matter imported for use as such, and organic intermediate products imported for their manufacture).

Part II. of the Safeguarding of Industries Act deals specifically with the prevention of dumping. It defines dumping

¹ *Final Report of the Committee on Commercial and Industrial Policy after the War* (Cd. 9035, 1918).

as the sale of goods at prices lower than "the prices at which similar goods can be profitably manufactured in the United Kingdom." It gives power to the Board of Trade to submit any complaint received from the manufacturers of a commodity with regard to dumping for the consideration of a special committee, and if the committee reports that a complaint is justified then the Board may make an order applying the Act to the class of goods about which the complaint has been received. In this way the Act was extended in 1922 to five classes of goods: fabric gloves and glove fabric, domestic glassware, illuminating glassware, domestic hollow-ware, and German gas mantles; and since this date it has been further extended to include other classes of commodities, among which are lace and embroidery, and certain kinds of cutlery.

It is interesting to note that a special committee appointed by the Board of Trade to consider the working and general effects of the Act reported in 1926 in favour of its continuation and advocated, in certain cases, an increase of the rates of duty.

The Safeguarding of Industries Act had, however, been preceded by a series of protective duties known as the McKenna Duties, which were introduced in 1915 during the Chancellorship of the Exchequer of Mr. Reginald McKenna. These were chiefly applied to the motor industry. Duties of 33½ per cent. were levied on imported motor cars and motor cycles together with such commodities as clocks, watches, cinema films, and musical instruments.

The McKenna Duties and the Safeguarding of Industries Act made the first and second big breaches in the British free trade system, breaches which have recently been made very much bigger as a result of the financial crisis which took place in this country in 1931 and in consequence of which a National Government was returned to power. Early in the following year the new Government passed an Import Duties Act

liquidated from six to eight years.¹ In addition, the British Government has within recent years protected the sugar beet industry by means of big subsidies. In 1931-32 the sugar beet subsidy amounted to £2,375,000, and in 1932-33 to £2,400,000, and recent statistics of output show that this industry has made rapid strides.

But though Great Britain has now adopted a comprehensive system of tariffs the great feature of the history of British trade in the nineteenth century is the predominance of free trade. We know how the old British protective system of the eighteenth century was gradually broken down in the nineteenth by Huskisson, who between 1823 and 1827 reduced the duties on silk and wool and simplified the Navigation Laws; by Peel with his famous free trade Budgets of 1842 and 1845, which greatly reduced the number of imports liable to duty, and his sweeping away of the Corn Laws in 1846 and the final remnants of the Navigation Laws in 1849; and by Gladstone who continued Peel's policy of simplifying the tariff system in his remarkable Budgets of 1853 and 1860, and who arranged in the latter year an important commercial treaty with France under which the trade between Britain and France was made freer, French manufactured goods being allowed into Britain free and French wines under reduced duties.

But the prophecy of that outstanding free-trader and Manchester manufacturer, Richard Cobden, in the year the British Corn Laws were repealed, that within five years the countries of Europe would all be simplifying their tariff systems according to the British model, was not fulfilled.

¹ The Trade Facilities Act of 1920 and its various amending Acts have now expired, and no further guarantees can therefore be given under them. The last of the loans guaranteed under these Acts was that of £1,000,000 to the Hungarian Transdanubian Electrical Company in May 1928. Both the interest and principal of this loan are guaranteed by the British Government on condition that the money raised is expended in Great Britain on the purchase of machinery and materials.

always been the dominant note of economic policy since the days of that famous American protectionist Alexander Hamilton, who is regarded by Professor Bastable as the earliest advocate—in his *Report on Manufactures* (1791)—of protection as distinguished from its precursor mercantilism,¹ which reached its high water mark between the beginning of the sixteenth century and the middle of the eighteenth. In fact, an outstanding British eighteenth century economist, Sir James Steuart (1712-80), who, nine years before the *Wealth of Nations* appeared, published in 1767 his *Inquiry into the Principles of Political Economy*, has been termed “the last of the Mercantilists.”

Mercantilism is a system which has been much misunderstood. Most economic historians, however, now consider that it was not inappropriate to the period in which it flourished. It may be described as a system of excessive state regulation, the objects of which were: an invariable excess of exports over imports, the accumulation of the precious metals, the increase of shipping, and the prohibition of trade with certain countries. Imports of raw materials were encouraged; every effort was made by the levying of high duties to discourage the importation of manufactured goods; exports were stimulated in every possible way. Even colonies were exploited for the sole benefit of the mother country, as is shown by the English Navigation Acts of 1651 and 1660, the Staple Act of 1663, and the Plantation Duties Act of 1673. Colonies were regarded, not only in England but also in France, Holland, Spain, and Portugal as “estates” which were to be at the entire disposal of the mother country as sources of supply and markets. “The worst features of the mercantile system,” writes Professor Bastable, “appear in the treatment of colonies and dependencies.”²

Mercantilism attained its fullest development in England

¹ *Commerce of Nations*, p. 120.

² *Ibid.*, p. 38.

"INVISIBLE" EXPORTS.

result, there is a big influx of interest on these loans each year. British banking and insurance firms do a great deal of business in foreign countries, and in this way draw a large amount of income. British settlers overseas regularly remit large sums to the mother country, while very much money is spent every year in Britain by foreigners who visit the country for pleasure. "There are," states Mr. Hartley Withers,¹ "many more exports in heaven and earth than are dreamt of by the philosophy of the Board of Trade."

As an illustration of what has just been said, the interesting analysis of the trade returns of the United States presented to President Coolidge by Mr. Hoover, the Secretary of Commerce, in his annual report for the fiscal year ending July 1, 1927, may be quoted. In this analysis it will be noted how the trade of the United States differs from that of Great Britain, for its exports of merchandise, i.e. its "visible" exports, are far greater than its imports of merchandise.

Mr. Hoover states that "the excess of exports over imports (the so-called favourable balance of merchandise trade) in 1926-7 was \$716,000,000, a very much greater figure than that of the year before, and somewhat greater than the average of the five years, 1922-6. In part payment of this balance there was a net gold import of \$148,000,000. However, the other factors in our international balance of accounts are of vast and increasing importance, and undue significance is not to be attached to the balances in the movement of merchandise and of gold alone. As in other years, 1926-7 witnessed the great purchase of foreign bonds and other investments for which exports must pay. There was also a heavy tourist travel and a large volume of immigrant remittances. On the other hand, each year shows a greater income from previous investments abroad, and such income, of course, contributes one of the means for paying for merchandise imports."

This analysis is striking evidence not only of the economic

¹ *The Meaning of Money*, p. 190.

prosperity of the United States but also of the enormous development of international trade during the last hundred years, a period which has witnessed a remarkable expansion in the markets of the world. Since the middle of the nineteenth century new international trade routes have been opened, countless new markets and distributing centres have been established, and vast commercial hinterlands have been rapidly developed, such as the corn lands of the Middle West of the United States and of the prairies of Canada, the veldt of South Africa, the sugar plantations of Queensland, the pastoral lands of New South Wales and New Zealand, and the cotton fields of the Southern States of America and of Nigeria, to mention but a few of the great areas which were virgin ground when Waterloo was fought.

These developments have, of course, been greatly stimulated by the wonderful increase of transport facilities. "Improvement in transport," declares Professor Leffeldt,¹ "is the key to industry and even to the civilisation of the modern world." Since the days of Brindley and his famous Worsley to Manchester Canal, and of Telford and his great arterial Shrewsbury to Holyhead and Carlisle to Glasgow roads, there have been vast changes in the methods of transport. It is only just over a hundred years since that outstanding mechanical engineer, George Stephenson, ran his first railway locomotive in 1825 on the Stockton to Darlington railway track. In 1815 Symington's "Charlotte Dundas" was the first steamship to enter the Forth and Clyde canal, and in the same year the first ocean steamship sailed from Liverpool to Glasgow. In 1839 the first propeller was used by the steamship "Archimedes," and in 1861 the "Scotia" created a "record" by crossing the Atlantic from Liverpool to New York in nine days. The wooden sailing ship, however, gradually disappeared and was replaced by iron and steel steamships, which since 1880

¹ *Descriptive Economics* (1927), p. 58.

have rapidly increased in size and speed, until to-day some of the great ocean liners have a capacity of over 40,000 tons and a speed of 25 knots.

Moreover, though we still have the ocean "tramp," which carries all kinds of merchandise and incessantly varies its routes, many of the world's greatest steamships are organised in "lines" which are confined to certain special routes and special "trades." Some of these important ocean routes have been greatly shortened by the opening of the Suez Canal in 1869, and of the Panama Canal in 1914.

Professor Bogart has given us an interesting account of the extraordinarily rapid development of transportation in a great commercial country like the United States where the railroad mileage in two intensive decades, 1860 to 1880, was trebled. In 1860 the United States possessed about 30,000 miles of railway; in 1880 over 93,000. But there was a still more intensive decade to follow, for by 1890 the total length had been increased to over 163,000 miles. In 1869 the first American trans-continental railway was completed by the joining of the Union Pacific and the Central Pacific near Ogden in Utah; in 1886 the great Canadian Pacific Railway reached the shores of the Pacific at New Westminster. The completion of the Sault Ste. Marie Canal—the busiest internal waterway in the world—in 1855 linked up Lake Superior with the other lakes and with the Atlantic. "These unsalted seas," states Professor Bogart,¹ "afford a deep and practically unbroken channel of trade for 1,000 miles, providing cheap transportation for the heavy and bulky commodities produced in the area which they serve."

Thus were the great corn and mineral areas of the North American continent opened up, and thus did great new markets and distributing centres arise in its vast and rich hinterlands.

This great expansion of trade has been accompanied by the

¹ *Economic History of the United States*, p. 497.

many activities of Government departments in various countries for its supervision and encouragement. America has its Department of Commerce, which is engaged in the work of promoting the mining, manufacturing, shipping and transport interests of the United States. This Department is also responsible for the census, the enforcement of Government regulations appertaining to trade, the collection of trade statistics, the making of coast surveys, and the controlling of the Alaskan seal trade and the salmon and other fisheries. Its commercial attachés are to be found in the principal trading centres of the world, and its Bureau of Foreign and Domestic Commerce publishes a weekly journal known as *Commerce Reports* and a monthly *Survey of Current Business*. Great Britain has its Board of Trade, a department which dates from the time of Charles II., but which is now chiefly concerned with the regulative side of trade, with standards of weights and measures, with the control of patents, with bankruptcy, with trade and population statistics, and with the Government rules and regulations appertaining to railways, shipping, lighthouses, and water, gas, and electricity companies.

It cannot, therefore, be said that the main function of the British Board of Trade is the promotion of British trade. Unlike the American Department of Commerce it is not specially charged with the encouragement of trade; its functions are chiefly supervisory; its chief business is the enforcement of a vast number of legislative measures relating to trade and transport, though since 1919 a great part of its work in connection with transport has been transferred to a new Department—the Ministry of Transport.

But even before the establishment of the Ministry of Transport the supervising work of the Board of Trade had been so heavy that the British Government decided in 1917 to establish the Department of Overseas Trade for the special purpose of promoting British trade. This Department is really under the joint control of the Board of Trade and the

Foreign Office, and is concerned not only with the promotion and development of British overseas trade but also with commercial intelligence, for which purpose it possesses a large number of special intelligence officers. Its work is divided into three important sections: Empire; foreign; exhibitions and fairs. The information it collects is regularly published in the *Board of Trade Journal*, the official periodical of the Board of Trade, which is published on behalf of the Board by His Majesty's Stationery Office.

The *Board of Trade Journal* is a unique trade periodical which is highly valued by all the leading import and export houses, banks, insurance offices, shipping offices, commercial offices, and manufacturing firms throughout the world. Its chief object is officially described as the minimising of economic friction by making readily available all the latest trade news collected from every corner of the earth. The whole resources of the Board of Trade and of the Department of Overseas Trade are drawn upon in its production. It is therefore able to print early news of all openings for trade, trade exhibitions, fairs, tariffs, commercial treaties, and customs regulations, and on these subjects it is usually the first source, certainly the most authoritative source, and frequently the only source of information.

In addition to the *Board of Trade Journal* the British Government publishes another very important periodical which is of great service to traders, and which we have already referred to in our discussion of index numbers. This is the *Ministry of Labour Gazette*, which concentrates on the state of British internal trade. Published monthly, it gives, among other things, valuable information about the chief British industries, special articles on the trade and labour conditions of individual industries, employment statistics, miscellaneous statistics with reference to prices and wages, unemployment insurance statistics, details about trade disputes, and, as we have seen, the changes in the cost of living.

These two valuable economic periodicals circulate all over the world. Both, particularly the *Board of Trade Journal*, which specialises in world trade news, give information about trade conditions in countries other than Great Britain. Recently, however, there has been a strong reaction, both in Great Britain and in the British Dominions and Colonies, from world to imperial economies. With the great expansion of Empire trade imperial economic problems have rapidly acquired a paramount position. The system of colonial preferences, the various Imperial Economic Conferences, and the Great War, have brought the economic relations of Great Britain with the various units of its far-flung Empire into the forefront of British trade policy. Therefore, the British Government appointed in 1920 the Imperial Shipping Committee, and in 1925 the Imperial Economic Committee, both of which are authorised to report directly to the Governments represented at the Imperial Economic Conference.

The Imperial Shipping Committee is concerned with the problems of Empire trade and of maritime transport. It investigates complaints with reference to excessive freights and the facilities of transport, and makes recommendations with regard to dock accommodation, the safety and improvement of harbour works, and the size and speed of ships.

The Imperial Economic Committee is charged with the work of investigating and improving the methods of preparing for the markets of Great Britain the products of the Empire, with bettering the facilities for marketing these products, with increasing their consumption in preference to the products of foreign countries, and with promoting the interests of producers and consumers. On the recommendation of this Committee the British Government set up in May 1926 the now dissolved British Empire Marketing Board.

The British Empire Marketing Board, as its name implies, concentrated on the marketing of Empire products. But this was only one of its many economic activities. It was, of

course, first of all very much concerned with the guidance and persuasion of the consumer in his choice-making. It was also very much, and very properly, concerned with the quality of the products which the British Empire offers for sale. Therefore, it has established a number of Empire agricultural research stations, of which the most important is the Imperial College of Tropical Agriculture in Trinidad, and it made regular grants towards the investigation of such important economic problems as the further possibilities of cold storage, the best methods of controlling the ravages of insect pests, the quality of timber, the breeding of stock, and dairy research. "At one end of the Board's activities Kew and Trinidad combined to evolve a banana that shall be immune from 'Panama disease'; at another, visits were arranged of representatives of the primary producers from overseas that they may learn the precise wants of the British market."¹

In June 1927 the British Empire Marketing Board issued its first report,² which classifies the work of the Board into four broad divisions: (1) the making of grants for scientific research into problems of production and marketing, (2) the initiation and development of economic investigation and intelligence, (3) other schemes for the encouragement of production and marketing, (4) a publicity and educational campaign.

The second of these divisions is of outstanding importance in the development of marketing. Special attention was paid by the Board to the dissemination of market intelligence, such as information relating to crop prospects, harvests, shipments, and arrivals at ports; to the elimination of waste in transit, particularly with reference to the deterioration of fruit; and to the encouragement of the primary producers of the Empire to pay personal visits to the markets of Great Britain in order to study the present and future needs of the consumers.

The fourth section of the Board's activities related to the

¹ *The Manchester Guardian*, 6th July, 1927, leading article.

² Cmd. 2898, 1927.

guidance and persuasion of the consumer in his choice-making. The methods of attracting the consumer were five in number: newspaper advertisements; a series of striking posters depicting scenes of production in the British Empire; the showing of Empire products in the local trade exhibitions held in various parts of Great Britain; the innovation of Empire shopping weeks; and the cinema.

The Empire Marketing Board was dissolved in 1933, and some of its functions were taken over by the Imperial Economic Committee. At the end of 1937, a new body, the Colonial Marketing Board was set up under the Colonial Office, but as yet (1938) it has not fully developed its work.

SUMMARY OF CHAPTER XII.

How Trade Arises.—Commodities are exported because the exporting country is able to sell at a lower price than the importing country. This may be due to—

- (1) Climatic conditions.
- (2) Natural resources.
- (3) The superior initiative and greater effectiveness of the producers.

The Theory of Comparative Costs.—If two countries, *Y* and *Z*, trade in two commodities, wheat and cloth, and if *Z* produces wheat at 10s. a bushel and cloth at 5s. a yard, and *Y* produces wheat at 20s. a bushel and cloth at 10s. a yard, then *Z* possesses an advantage in both commodities. But the ratios (1 to 2) between the costs of production are identical, i.e. comparative costs are equal, therefore there can be no permanent trade. International trade becomes permanent when there are differences between comparative costs.

Protection.—Advocates of protection state among other things that—

- (1) New or "infant" industries need to be carefully guarded against foreign competition.
- (2) Import duties are a source of revenue paid by the foreign producer.
- (3) The protective system increases a nation's productive power.
- (4) It raises wages.
- (5) It results in a steady market.
- (6) It prevents "dumping."

The Reaction in Favour of Protection.—The various stages in Great Britain are:—

- (1) The McKenna Duties of 1915 chiefly affecting the motor industry.
- (2) The Safeguarding of Industries Act of 1921. Part I. of this Act is devoted to the safeguarding of key industries, and Part II. deals with the prevention of dumping.
- (3) The Import Duties Act which became operative on March 1, 1932. This historic measure swept away the old British free trade system and substituted a comprehensive system of tariffs. It also set up an independent Advisory Committee with power to add to the tariffs already adopted.

Empire Trade.—To stimulate the trade of the British Empire the Imperial Economic Conference, which met at Ottawa in August 1932, decided upon a new system of preferential tariffs for the British Dominions.

The Overseas Trade (Credits and Insurance) and the Trade Facilities Act.—Two other important Acts for encouraging trade passed by the British Parliament since the war are—

- (1) The Overseas (Credits and Insurance) Act (1920).
- (2) The Trade Facilities Act (1921).

The Free Trade Movement.—The old British protective system of the eighteenth century was broken down in the following century by—

- (1) Huskisson with his reduction of the duties on silk and wool, and the simplification of the Navigation Laws.
- (2) Peel with his Free Trade Budgets of 1842 and 1845.
- (3) Gladstone with his Free Trade Budgets of 1853 and 1860.

The Anglo-French commercial treaty of 1860 made trade between England and France freer. This was followed by further such treaties between various European countries.

After the Franco-Prussian War of 1870-1 a reaction set in in favour of protection.

Protection has always been the dominant factor in the United States.

Mercantilism.—Mercantilism may be described as a system of excessive state regulation, the objects of which are—

- (1) An invariable excess of material exports over imports.
- (2) The accumulation of the precious metals.

(3) The increase of shipping.

(4) The prohibition of trade with certain countries.

It attained its fullest development in England under Cromwell, Charles II., and William III., and in France under Colbert.

The Balance of Indebtedness.—The mercantilists were very much concerned with what they termed the "balance of trade," which they regarded as favourable when the export of merchandise was in excess of the import.

Modern economists speak of the "balance of indebtedness," and lay great stress upon what are termed "invisible" exports.

Great Britain earns large sums by means of "invisible" exports, such as interest on British loans to foreign countries (i.e. on the export of capital); and payments by foreign countries for the carrying of goods in British ships (i.e. for the export of services).

Transport.—The facilities of transport have rapidly increased since the days of Brindley, Telford, and Stephenson. In 1815 Symington's "Charlotte Dundas" was the first steamship to enter the Forth and Clyde canal; in 1825 George Stephenson ran his first railway locomotive.

The old wooden sailing ship was rapidly replaced after 1880 by iron and steel steamships.

Trade routes were shortened by the Suez Canal in 1869 and the Panama Canal in 1914.

Government Departments and Committees for the Regulation and Encouragement of Trade.—America has its Department of Commerce and Great Britain its Board of Trade. The former is specially charged with the development of American trade. The latter is chiefly concerned with the regulative side of British trade, and since 1919 most of its work in connection with transport has been transferred to a new department—the Ministry of Transport.

In 1917 the British Government established the Department of Overseas Trade for the special purpose of promoting British trade. The information it collects is regularly published in the *Board of Trade Journal*.

Another British Departmental paper is the *Ministry of Labour Gazette*, a periodical which is useful to traders particularly with reference to the state of internal trade.

In 1920 the British Government appointed the Imperial Shipping Committee, and in 1925 the Imperial Economic Committee. On the recommendation of the latter the British Marketing Board was established in 1926, and dissolved for reasons of economy in 1933.

CHAPTER XIII.

MARKETS.

"The gathering together of people at a convenient centre, at certain times of the year, or on certain days of the week, for the interchange of food and other necessities of life is one of the oldest practices of civilisation."—*Report on Markets and Fairs, Part I. (1927)*, published by the Ministry of Agriculture and Fisheries.

It is usual for the general reader to associate the term "market" with a hall or open space in a town where buyers and sellers meet. But the gathering of such a concourse of dealers in so limited a space is, under modern conditions of large scale industry, only the most rudimentary type of market. Yet scarcely a hundred years have elapsed since Manchester's first market hall for "butchers and greengrocers" was erected, while even so late as 1825 Birmingham possessed no such building for marketing purposes.¹ In all the important English provincial towns at the commencement of last century the produce market was held in the street, usually in a central square of the type still possessed by fine old cities like Norwich and Peterborough.²

These early produce markets were simply retail markets for the direct exchange of commodities between producer and

¹ Dr. Clapham, in his *Economic History of Great Britain*, Vol. I, p. 226, states that Liverpool "set the fashion in market halls when it opened in 1822 a hall . . . eleven hundred feet by two hundred."

² It must, however, be noted that a number of "Cloth Halls" for the sale of cloth and wool were in existence in such towns as Wakefield, Leeds, Halifax, and Bradford in the eighteenth century. The Mixed Cloth Hall of Leeds, for example, was built in 1755, and the Piece Hall of Bradford in 1773.

consumer, the produce sold being chiefly agricultural. Such markets still exist in many big centres, the buyers and sellers usually meeting weekly. But vast changes have taken place in markets and marketing since Liverpool erected the first big English provincial market hall in 1822, and with these changes the meaning of the term market has been greatly extended. We have only to consider the implications of such terms as "the Money Market," "the Stock Market," "the Oil Market," "the Cotton Market," "the Mining Share Market," "the Rubber Market," "the Coal Market," in order to realise the nature of this extension. "Originally," writes Jevons,¹ "a market was a public place in a town where provisions and other objects were exposed for sale; but the word has been generalised so as to mean any body of persons who are in intimate business relations and carry on extensive transactions in any commodity."

Markets must be distinguished from fairs. The old medieval fairs were really big markets, chiefly of a wholesale nature, in which the buyers and sellers were usually the bigger traders, the commodities being sold to the small buyers by itinerant pedlars or small packmen-merchants. Fairs still survive, but the fair day is now chiefly used as a pleasure day, and the fair ground as a meeting place of travelling showmen. In recent years, however, the term fair has been used in another way. It has been applied to big national or semi-national trade exhibitions, such as the annual British Industries Fair. The term fair is becoming increasingly popular as a descriptive title of such exhibitions.

Long, however, before the old type of medieval fair—an excellent English example was that held at Sturbridge² near

¹ *Theory of Political Economy* (1879), p. 91.

² "There clothiers from Leeds and Norwich rubbed shoulders with linen merchants from the Lowlands of Scotland, and cutlers from Sheffield with nail-makers from Birmingham." Mantoux, *The Industrial Revolution in the Eighteenth Century*, p. 112. Sturbridge Fair still survives.

Cambridge, of which Defoe has given us an interesting description in his *Tour of Britain*¹—had commenced to decline, both produce and financial middlemen had appeared, and these dealers were quite numerous even so early as the sixteenth century. Wool and corn middlemen—"broggers" and "bodgers" as they were then termed—were well-known in the England of the Tudors. The financial middlemen helped the merchants to adjust their accounts, and granted them credit. They were originally money-changers, or dealers in foreign moneys, and, as such, were indispensable at the old fairs where traders from many countries met. Their original business was the changing of the money of the foreign merchants who visited the fair for the coins of the country where the fair was held. These money-changers, or *campsores* as they were termed in Italy, were the first European bankers.

The old type of fair declined with the growth of capitalism and the development of agriculture and of the factory system. As the scale of producing commodities increased it became more and more difficult to sell in bulk in fairs or small markets. As agriculture, for example, developed, the farmers began to produce in bigger quantities than could be sold in small lots in the fairs. This gave rise to the local dealer who developed into a retailer, and also to the dealer who distributed the produce to other centres. But the volume of produce increased so rapidly that sellers had to resort to dealing by sample, and as this method grew markets emerged which not only covered far wider areas but also greatly increased the forces of competition.

When dealing by sample was commenced, markets were still of the mixed variety, that is to say, each wholesale market dealt in a number of commodities. But the wholesale market carrying out big dealings in a single commodity, such as sugar, corn, or cotton, soon appeared. This is the type which

¹ Vol. I., pp. 122-30. Defoe's *Tour* is in three volumes, and was published between 1724 and 1727.

is now often termed an exchange, and whose field of operations is the world.

Thus the Liverpool Cotton Exchange, for instance, is the most important cotton market in the world. The dealers, or "members" of this exchange conduct their transactions in a palatial building, transactions which may be concerned with cotton crops in the United States, in Egypt, in the West Indies, in India, or in Brazil, and, moreover, transactions which can be conducted without the buyers or the sellers even seeing a sample of the goods. Indeed, there are many buyers operating in big produce exchanges of this nature who buy, not because they want to buy the goods in order to sell to the consumers, but because they hope, by making very large bulk purchases, to take advantage of the slightest rise in the market price and immediately re-sell without even seeing the commodity in which the deal is conducted.

Another great institution of this nature is the London Metal Exchange which deals in the base metals—copper, tin, and lead. The big dealings in this exchange regulate the prices in the metal markets of the world, but no samples of the commodities are to be seen in the "ring" of the building where the dealers meet. The metals sold are all carefully graded. Tin is sold on the basis of what is termed "standard tin," the metal in this case containing a minimum content of 99.75 per cent. tin. Bought in the London Metal Exchange, it may be delivered to the buyer from the Straits Settlements, Nigeria, or Cornwall.

It is clear that a big exchange of this kind which deals in commodities drawn from the whole world must be particularly well organised, and that none but highly trained specialists can participate in its activities. Only men of exceptional character are allowed to become dealers in the big specialised markets and exchanges; the entrance fees are very high, and large sums are demanded as securities. In the London Metal Exchange over one hundred firms are represented. Their representatives

in the exchange have to pay an entrance fee of a hundred guineas, and provide a security of £3,000, while before they are allowed to deal in the "ring," in copper, tin, and lead, they have to pay an additional fee of five hundred guineas.

The graded commodities in which these big exchanges deal are sometimes warehoused before dealings commence. But by far the greater part of the transactions in such markets are concerned with future supplies—"dealings in futures"—and, therefore, are of a speculative character. And so, also, in markets for capital, such as the London Stock Exchange, speculative dealings predominate. A market of the latter type is chiefly concerned with the buying and selling of capital already invested, an operation which must be carefully distinguished from the obtaining of new capital for investment, which is the business of other financial institutions such as the banks. The business of a big money market like that of London is, however, a subject which we shall have to consider in more detail a little later,¹ after we have first of all examined the meaning of money itself.

All these specialised markets of whatever type—produce or capital—offer wide fields for the speculative dealer. In produce markets dealings in futures, in well-graded commodities, are quite as easily carried out as dealings in present supplies, for such transactions simply mean that the buyer deals in documents which give him the right to the produce at some future date, and these documents may pass through the hands of many dealers before they get into the hands of the buyer who ultimately obtains the commodity.

The dealers in these specialised markets are highly qualified experts. Their buying and selling depends on a sound knowledge of the sources of supply of the commodity in which they deal. They buy ahead of demand, and therefore, in order to reduce their own personal risk, have not only to be thoroughly acquainted with the present state of demand but

¹ See Chap. XVII., *infra*.

also have to estimate with great accuracy the possible future demand. The wider the market the more successful are their estimates, and as a result the fluctuations of prices are considerably reduced.

The operations of such specialist dealers are, therefore, of the utmost importance in retaining the level of prices. Their dealings are termed "legitimate" speculation because they fundamentally depend on skill, foresight, and an expert knowledge of the many conditions which influence the supply of, and the demand for, their special commodity. In such commodities as wheat, wool, cotton, coal, copper, lead, and tin their transactions are simplified by the excellent system of standardising or grading, while the risks, and therefore the price fluctuations, are again reduced by members of the exchange, or brokers, as they are usually termed, buying and selling among themselves. It is not uncommon for a big broker who has carried out a large transaction, say, a sale for future delivery, to buy part of the amount guaranteed from a fellow broker.

In these big exchange operations time, of course, is the most important element, but it must not be forgotten that the price of the commodity is settled when the contract is made. Thus, though the cotton, wool, or wheat is not delivered to the buyer for perhaps twelve months, the price remains unchanged. The dealer, as Professor Taussig states, "virtually guarantees a certain price for the future, and takes his chances as to whether the guarantee will bring him loss or gain."¹ Even the smallest retail trader is really a "legitimate" speculator, for he has to take certain risks in buying in anticipation of demand, and has to possess some knowledge of price movements.

Though, however, the exchange dealer or broker is the actual buyer in the market, he is not the person who sells the commodity to the consumer. The broker sells to, or buys on

¹ *Principles of Economics*, Vol. I., p. 159.

behalf of, a big wholesale merchant, who in turn sells to a "wholesale-retailer," who sells to a small retailer. Thus between the exchange dealer and the actual consumer there are a number of middlemen who gradually increase the price so that, when the commodity reaches the consumer, its selling price is perhaps double that which the exchange broker originally paid to the producer.

But there is another type of dealing in the exchanges and markets. This is the so-called "illegitimate" speculation, or gambling, which depends entirely on chance, and, therefore, does not require even the most elementary knowledge of the actual conditions of the demand for, and the supply of, the commodity dealt in. "Illegitimate" speculation is particularly harmful to a community, and is nearly always the work of "dabblers on the exchange" or outsiders who are not members of the expert class of brokers. Moreover, these "dabblers" or "blind" dealers often complicate matters by dealing with borrowed capital, or with insufficient capital, and by deliberate attempts to influence the process of marketing by circulating false reports among the buyers and sellers. Both produce and capital markets suffer from their operations, which sometimes result in serious price fluctuations. "The New York Exchange," writes Professor Taussig,² "is at once the greatest institution in the world for facilitating investment and the greatest of gambling hells."

On the other hand, even the "legitimate" speculators sometimes operate in such a way as to interfere with the ordinary working of the exchange or market. This may be done if a broker attempts to secure control of the available supply of a commodity over a certain period, or, in other words, attempts to "corner" the supply. It may also be done if a broker sells far more than his customary amount of a commodity, in order to create a big reduction of prices which will ultimately enable him to make a number of cheap deals.

² *Principles of Economics*, Vol. I., p. 165.

In a market like the London Stock Exchange, whose chief function is, as has been emphasised, the marketing of capital already invested in business enterprise, the buying and selling of stocks and shares, the transactions are very large and very numerous. Therefore, instead of the brokers settling with one another immediately a deal is concluded, a special settling day is fixed by the Committee of Management, which is the controlling body of this great world-wide market.

The London Stock Exchange is really a select club, membership of which is not easy to obtain. Its Committee of Management is confined to thirty persons elected annually by the members, and it possesses considerable powers, such as the immediate expulsion of a dishonest member. The members of the London Stock Exchange are of two classes: stock-brokers and stock-jobbers. The broker acts on behalf of the outside public; the jobber does the actual buying and selling on behalf of the broker.

During recent years, however, this classification has not been quite so rigid. Many of the brokers now do a certain amount of buying and selling in the exchange, thus dispensing with the services of a jobber. It must, moreover, be remembered that in London—and this is the case also in other great money markets—there are a number of outside brokers who are not members of the Stock Exchange. These outsiders make use of Stock Exchange information without contributing to the upkeep of the institution, but though there are some shady speculators among them, there are also some very respectable dealers.

The broker when he visits the exchange for business purposes does not reveal the name of his customer, therefore, in accordance with English law, if the broker deals through a jobber, the broker, and not the customer, is entirely responsible to the jobber for any transactions that the latter carries out for the broker on behalf of his customer. On the other hand, the broker, in view of the fact that he discloses the jobber's

name to the customer, is not legally responsible to his customer if the jobber fails in any way to carry out the deal in accordance with the agreement. But in this latter case the brokers, who are members of the Stock Exchange, always assume liability for the jobber engaged in the transactions, otherwise they would not be re-elected as members. It is thus clear that the methods of dealing in the London Stock Exchange are rigidly supervised. The liability of the brokers to their customers among the outside public is carefully defined and limited by law and by the custom of the market.

There is, of course, a great deal of buying and selling of shares by dealers who do not intend to hold their purchases, and such dealings are carried out by both the regular and outside brokers. These speculative dealings have been facilitated by a system under which the brokers who cannot settle their accounts on the fixed settlement day are allowed to borrow for this purpose from other brokers, termed "contango" brokers. The brokers can also borrow from the banks, but the banks are apt to limit their loans, and therefore the borrowers often get less than they require. It is when the broker is unable to complete his settlement with loans from a bank that he resorts to the "contango" broker—a specialist who, however, does not advance large sums as a bank does. He simply takes over the stock or shares, which the borrowing broker is accountable for, in his own name until the next settlement day, and he receives a payment termed "contango," which is really his interest on the transaction. This is called "carrying over," and is a system which has intensified speculation because the ordinary brokers are thus able to buy and sell in a larger way, and to take bigger risks, than would be possible without the assistance of the "contango" broker, who, to all intents and purposes, is really a pawnbroker in stocks and shares.

There has, therefore, been a big increase in the London Stock Exchange speculative dealings in price differences, the

so-called "bull" and "bear" transactions. The "bull" buys shares for the purpose of forcing up prices and then selling out at a profit; the "bear" sells shares in order to reduce prices and then buy in again at the lower price. Such operations sometimes lead to serious price fluctuations in the particular class of shares in which these operators speculate.

If, however, a broker who, through a jobber, has bought a large number of shares for a customer, is unable for some reason or other to hand over these shares on the day of settlement, he finds a broker who holds a number of shares of the same class, and borrows them from him for the occasion. The lender makes a charge for the accommodation, which is termed "backwardation," and which, like "contango," is really compensation money or interest for the loan of the shares for a certain period.

SUMMARY OF CHAPTER XIII.

The Evolution of Markets.—In all the important English towns the produce market was held in the street at the beginning of last century. It was not until 1822 that the first big provincial market hall for marketing produce was erected at Liverpool.

The early produce markets were simply retail markets.

Markets must be distinguished from fairs. The old medieval fairs, however, were really big markets. The fair day is now used as a pleasure day. But in recent years the term fair has been applied to big trade exhibitions, such as the annual British Industries Fair.

Long before the old medieval fair had commenced to decline in importance both produce and financial middlemen had appeared.

The financial middlemen of the medieval fair were originally money-changers, or dealers in foreign moneys, or *campeiros* as they were termed in Italy. They were the first European bankers.

As agriculture developed farmers produced in bigger quantities than could be sold at the fairs. This gave rise to the local dealer or retailer, and the distributor. But as the volume of trade increased sellers and buyers commenced to deal by sample,

Modern Organised Markets.—When dealing by sample originated, markets were still mixed. The next and final stage was the emergence of the market, or exchange, as it is called, which deals by sample in one commodity only, *e.g.* the Liverpool Cotton Exchange, the London Metal Exchange.

Such markets are concerned with future supplies; they deal in "futures," and are therefore speculative markets.

The London Stock Exchange, which deals in capital already invested, is also a speculative market.

Speculation.—The dealers in organised markets are specialists. Their operations are of the greatest importance in steadying prices. They are the "legitimate" speculators, and their operations depend upon skill, foresight, and an expert knowledge of the money conditions which influence the supply of, and the demand for, their special commodity.

These dealers or brokers do not sell what they buy directly to the consumer. There are various intermediaries, such as the wholesale merchant and the "wholesaler-retailer," between the exchange broker and the consumer.

"Illegitimate" speculation depends entirely on chance; it does not require any specialised knowledge. Such speculation is harmful to a community.

The London Stock Exchange.—This great market specialises in the buying and selling of stocks and shares. The brokers settle their accounts on fixed days.

It is not easy to become a member of the London Stock Exchange, for it is really a select club with a Committee of Management of thirty persons possessing great powers. The members are of two kinds:

(1) The stock-broker, who acts on behalf of the outside public.

(2) The stock-jobber, who does the actual buying and selling on behalf of the broker.

But during recent years this classification has not been quite so rigid, for many of the brokers now buy and sell in the market.

There is a great deal of buying and selling of shares by brokers who do not intend to hold their purchases. Some buy shares for the purpose of forcing up prices and then selling at a profit. Others sell in order to reduce prices and then buy in again at the lower price. The former are termed "bulls," the latter "bears."

Speculative dealings of this nature are made easier because the dealers who cannot settle their accounts on the fixed settlement day are allowed to pass the stocks and shares which, they are accountable

for, to the so-called "contango" brokers. These brokers hold such stocks and shares in their own names until the next settlement day, receiving for so doing a payment termed "contango."

If a dealer who has bought a number of shares for a customer is unable to hand them over on the day of settlement, he borrows a number of shares of the same class from another dealer, and pays him for this loan what is termed "backwardation."

CHAPTER XIV.

MONEY.

"I agree that no topic can claim to be so important as that of currency."—Mr. Winston Churchill, in Parliament, June 25, 1927.

"There is in truth no department of Economic Science in which law is more inexorable than in regard to the problems of money and currency."—Sir John Marriott, *Economics and Ethics*.

We have now arrived at what is perhaps the most interesting part of Economics—the study of money, credit, banking, and foreign exchange or, more briefly, of the mechanism of exchange. Though this section has come very much to the fore as a result of the Great War, Englishmen do not, generally speaking, take a very deep interest in monetary problems. This is primarily due to the smooth working of the English banking system, and to the non-recurrence since 1866 of big financial panics in England. It is also to some extent due to the fact that English economists have not until quite recently given very much attention to monetary economics.

At the outset we must attempt to define money. This, as we shall see, is not an easy matter, because, like the term wealth, the term money can be used in a broad or in a narrow sense, and also because economists frequently differ when analysing its meaning.

As an illustration of the divergence of opinion among

academic economists with regard to the problem of defining money, let us take the definitions of two distinguished former professors—Marshall of Cambridge, and Bonamy Price of Oxford. "Coin, metallic coin, alone," writes the latter, "is true money, and nothing else is unless it be a commodity, as an ox, or a cow, or a piece of salt. There is a very decisive reason for this assertion. Every kind of paper styled money carries on its face an order or promise to pay money. . . . An order or promise to give a thing is not the thing itself. This settles the matter absolutely: paper is not money." "Nevertheless," he adds a little later in the same treatise, "though banknotes are not money, it is hopeless to try and strip them of that title."¹

Marshall, on the other hand, in his last work, *Money, Credit, and Commerce*, defines money as that which consists of "all those things which are (at any time and place) generally current without doubt or special inquiry as a means of purchasing commodities and services and of defraying commercial obligations."²

But while we may follow Marshall and regard money as any commodity that passes freely from hand to hand as a medium of exchange, or, in other words, any commodity that is readily accepted as payment for other commodities without, as Walker puts it, "reference to the character or credit of the person tendering it,"³ we must remember that in modern communities money chiefly consists of balances at the banks by means of which debts are settled by book transfers. "Many of the misconceptions regarding money," states Mr. Reginald McKenna, the Chairman of the Midland Bank, in one of his post-war addresses,⁴ "arise from the old idea that

¹ *Currency and Banking* (1876), p. 38. Bonamy Price (1807-88) was Professor of Political Economy at Oxford from 1868 to 1888.

² P. 13.

³ *Political Economy*, p. 123.

⁴ An address on "Banking" given at the Guildhouse, Eccleston Square, London, on 11th December, 1927.

it consists in the main of notes and gold, silver, and copper coin. To-day that is no longer true. Money in the main consists of balances at the banks, and the notes and coins perform only a secondary function in the whole machinery of exchange."¹

Money is first of all a medium of exchange or a means of payment, and thus it dispenses with the inconveniences of bartering—of exchanging goods for other goods. Money is also a common measure of the value of an article, of the article's value in exchange as reflected in its price, for price as we have seen is simply a money measure of value. It is, therefore, what has been termed "a common denominator or a common measure of value."² Furthermore, money may be used as a standard of deferred payments, in order to enable us to estimate the amount of a future payment, if, of course, it does not itself fluctuate greatly in purchasing power.

These, then, are three of the functions of money. We must next consider the various kinds of money in circulation. There are, as is well known, two broad divisions: metallic and paper. Each country has different types of metallic money; gold, silver, nickel, copper, and aluminium have all been used for the manufacture of coins. The more precious metals—gold and silver—were selected for this purpose chiefly because they are durable, easily recognisable, easily moulded, and, under normal conditions, comparatively stable in price. During the war period, however, as will be discussed presently, the ordinary price stability of gold and silver was seriously disturbed.

During the war period, also, in most European countries

¹ Mr. McKenna's statement may be compared with Professor Lohfeldt's definition in the *Quarterly Journal of Economics* of November, 1927: "Money, nowadays, in an advanced community," he states, "means bank deposits. Metallic and paper money play a minor and diminishing role."

² Jevons, *Money and the Mechanism of Exchange* (twenty-third ed., 1910), p. 5.

gold went out of circulation and was replaced by paper, and what is termed the gold standard system ceased to function. In Great Britain the gold standard was inoperative between 1914 and 1925 after having previously functioned without a break for ninety-eight years. Under the Coinage Act of 1816¹ the sovereign became the standard British coin with full legal tender, while silver coins, which, with guineas, had prior to this date been full legal tender, were reduced to a legal tender power of £2. Thus Great Britain became a monometallic country—a country with a single metallic standard—and the system of bimetallism, under which both gold and silver are accepted in unlimited quantities in settlement of debts, disappeared. Great Britain's return to the gold standard in 1925 is an event of outstanding importance, which will be described in a subsequent section.²

We must, however, carefully distinguish between "standard money" and the "standard of value." The sovereign is the "standard money" of Britain, whereas the metal of which it is made is the "standard of value." Gold is thus the "standard of value" in a monometallic country, and gold and silver in a bimetallic country. Sovereigns (and half-sovereigns) are coined in the British Mint free of charge, but in some countries, like France, a small charge termed *mintage* or *brassage* is made, which covers the actual expenses of minting. If more than this is charged, as is sometimes done in certain European mints, the excess which constitutes a profit, is termed *seigniorage*.

In the British Mint, therefore, the coinage of gold is said to be gratuitous because no charge is made for the actual work of coining. Prior to the passing of the Gold Standard Act in 1925,³ all persons were free to take gold bullion for coining direct to the Mint, receiving in return £3 17s. 10½d. for each ounce (troy) of "standard" gold, which, as will be

¹ 56 Geo. III., c. 68.

² See Chap. XVI, *infra*.

³ 15 and 16 Geo. 5, c. 29.

explained presently, contains a small proportion of alloy. But the Gold Standard Act cancelled section eight of the British Coinage Act of 1870,¹ which entitled any person bringing gold bullion to the Mint to have it "assayed, coined and delivered out" to him "without any charge for such assaying or coining, or for waste in coining." All gold bullion for coining must now pass through the Bank of England to the Mint. The Bank pays £3 17s. 9d. for each ounce of "standard" gold, and, of course, receives for each ounce of bullion which it forwards to the Mint £3 17s. 10½d. "The margin of 1½d. per ounce," writes Mr. Clare,² "goes into the Bank's pocket, but, strictly speaking, is not profit. It is rather a compensation paid to the Bank for the trouble and expense of sending the bars to the Mint, in case it should be required to convert them into coin."

It must also be noted that the Bank of England was under the Gold Standard Act of 1925 "bound to sell to any persons" gold bullion at £3 17s. 10½d. per ounce of "standard" gold, but only in the form of bars containing a minimum of 400 ounces (troy) of pure gold. This meant, of course, that the Bank was compelled to cash its notes provided that the total presented was not less than the equivalent of 400 ounces of gold at £3 17s. 10½d. per ounce. When Great Britain renounced the gold standard in 1931 the section of the Act of 1925 relating to the selling of gold by the Bank was suspended, and as a result, the Bank is not now compelled to cash any of its notes, i.e. to sell any of its gold to the public.

The British Mint coins 480 ounces of "standard" gold into 1,869 sovereigns, and as each ounce is equivalent to $3\frac{1}{16}\frac{4}{8}$ sovereigns it will be seen why the Mint price of "standard" gold never varies from £3 17s. 10½d. per ounce. Both the Bank and the Mint prices are fixed by law, and must be carefully distinguished from the market price, which before the war

¹ 33 and 34 Vict., c. 10.

² *A Money Market Primer*, (1921 ed.), pp. 21-2.

always kept very close to these prices. During the war, however, the gold production of the British Empire was, under the authority of the British Government, commandeered by the Bank at the price of £3 17s. 9d. per ounce, a restriction which was not removed until September 12, 1919. Since this date gold bullion has been sold in the open market like other commodities to the highest bidders, and during recent years there have been striking variations in its price. On February 5, 1920, it reached a market price of £6 7s. 4d. per ounce of pure gold; on January 12, 1928, it was £4 4s. 11½d.; and on November 29, 1932, as a result of a financial crisis, it was £6 10s. 8d., the highest figure ever recorded in this country.

The gold converted into coins is, as has just been mentioned, what is known as "standard" gold; the price paid in the open market is for pure gold. British coins of "standard" gold contain $\frac{23}{24}$ ths of absolutely pure or "fine" gold and $\frac{1}{24}$ ths of alloy. The Bank of England's price of £3 17s. 9d. for an ounce of "standard" gold is, therefore, practically equivalent to a market price of £4 4s. 11½d. per ounce of pure gold.

The British sovereign is thus $\frac{11}{12}$ ths "fine" or, to be more exact, it possesses a "fineness" of 916·6, which means that an ounce of "standard" gold divided into 1,000 parts would contain 916·66 parts of pure gold and 83·34 of alloy. In France, Germany, and the United States "standard" gold is $\frac{9}{10}$ ths "fine."

Therefore, when it is stated that the sovereign contains 113·0016 grains of "fine" gold, it must be remembered that this is not the full legal weight, for the weight of the alloy is not included. A sovereign when it leaves the Mint must weigh 123·27447 grains of "standard" gold.

But the sovereign and the half-sovereign are not the only gold coins which the British Mint is authorised to coin. There are, in addition, the five-pound and two-pound pieces which, however, were curiosities even before the war. The Mint, also, used to coin ten varieties—since 1927 reduced to nine

by the discontinuation of the double-florin—of silver coins: the crown, double-florin, the half-crown, the florin, the shilling, the sixpence, the groat, the threepence, the twopence, and the silver penny. The metal used for silver coins is termed "standard" silver. Prior to 1920 it contained $\frac{37}{40}$ ths of "fine" silver and $\frac{3}{40}$ ths of alloy, or, more accurately, 925 parts out of each 1,000 of the metal used for coining silver coins were pure silver. Thus British "standard" silver used to possess a "millesimal fineness" of 925.

Now, during the war the price of silver rose much more rapidly than the price of gold. Indeed, there was such a remarkable rise in the price of silver during this period that both the British and American Governments were compelled to introduce measures for the purpose of controlling its price. A British Treasury Order, dated August 12, 1918, fixed the maximum price of silver at $48\frac{1}{2}$ d. per "standard" ounce, and eight days later another such order fixed the maximum at $49\frac{1}{2}$ d., a controlled price which continued until May 5, 1919.

A few days before the war was declared silver in England cost just over 2s. an ounce; in 1917 the average price was 4s. 7d., and in 1920 7s. $5\frac{1}{2}$ d. In view of this remarkable increase in price the British Government passed in 1920 a special Coinage Act (10 Geo. V., c.3) under which the "millesimal fineness" of the silver used for minting was reduced from 925 fine to 500 fine, thus making the new coins one-half silver and one-half alloy. Though silver has greatly decreased in price since 1920, this is still the fineness of British silver coins.

But the metallic content of a British silver coin, even when minted at the old standard of fineness, is not worth the face value of the coin. There is, for instance, not five shillings' worth of pure silver in the British crown piece or a shilling's worth of silver in the British shilling. And so, also, the metallic content of a British "copper" coin, which is 95 parts copper, 4 parts tin, and 1 part zinc, is not worth the

face value of the coin; a penny does not contain a penny-worth of bronze. A coin in which the metallic content is not worth its face value is called "token" money, and in this way the British silver and "copper" coins resemble paper money, which we must next describe.

Strictly speaking there are only two classes of paper money: (1) that which is fully backed by gold or silver, or in other words, every note of which in circulation is represented within the strong-rooms of a bank or of the national Treasury, by an amount of gold or silver equal to its face value; and (2) that which is not fully backed in this way.

The former class is termed representative money, and is convertible into gold or silver. In the second class the notes may be convertible or inconvertible; they may have a partial metallic backing or no backing at all. Notes issued without any metallic backing are termed fiduciary paper money; inconvertible paper money of this kind is circulated by a Government for the purpose of paying its debts.

We may now select from the world's paper money certain outstanding types as illustrations of our classification. The German notes issued during and immediately after the war were fiduciary or "fiat" money. They had no metallic backing, but though inconvertible and issued in such colossal numbers they functioned as a medium of exchange within the boundaries of Germany. Externally, of course, such paper money is valueless, and this enormous inflation of the German currency was spoken of internationally as "the absolute collapse of the mark." But since the complete re-organisation of the great German central bank, the Reichsbank, the issue of paper money in Germany has been greatly reduced and placed on a partial gold basis.

The United States gold and silver "certificates" were examples of representative money. They were fully backed by gold and silver, and we may therefore say that all those in circulation were 100 per cent. strong.

English paper money is partially backed by gold. Under the Currency and Bank Notes Act of 1928, which will be examined in more detail a little later, the Bank of England has been given sole control over the issue of English paper money, and as a result no more Treasury notes are to be circulated. But for some months prior to the passing of this important measure all the Bank of England notes actually in circulation were fully backed by gold, and were, therefore, representative money. On February 1, 1928, for instance, the total amount of these notes in the hands of the general public was £135,835,635, while on the same date there was £154,998,200 in gold coin and bullion in the Bank's vaults.

On the other hand the British Treasury notes were issued under the authority of the Currency and Bank Notes Act of 1914, were controlled by the Treasury, and were, until the passing of the Gold Standard Act in 1925, convertible at the Bank of England. Up to May 12, 1915, their metallic backing stood at £28,500,000 in gold coin and bullion, to which £3,000,000 in silver coin was added on April 20, 1921, while shortly after the latter date the backing was again augmented, this time with Bank of England notes.

Thus on March 25, 1925, according to the Currency Note Redemption Account, the backing of these notes was £27,000,000 in gold coin and bullion, £7,000,000 in silver, and £26,950,000 in Bank of England notes. Not long after this information was published the gold coin and bullion security disappeared from the account, for this security was handed over to the Bank of England in return for Bank notes to this amount. As a result the backing of Bank notes was increased to £53,950,000, but the 1927 Currency Note Redemption Accounts show that the silver was reduced to £6,300,000. Thus the only actual metallic security that has figured in the more recent of these statements is the item "silver coin." On June 8, 1927, the Treasury notes in circulation reached the enormous sum of £244,935,128, the

highest total for this particular year. By December 28, of the same year the total in circulation had dropped to £242,277,817.

When it is recalled that in July 1914 there were no British Treasury notes, and that the average weekly circulation of Bank of England notes during this month was just over £50,000,000, the statistics just given are striking evidence of the great increase of paper money in Britain.

It must, however, be remembered that the Bank of England was not the only British note-issuing bank in 1914, for a number of English, Scottish, and Irish banks also possessed the power to issue notes, but the total issues of the other note-issuing English banks in July 1914 only averaged about £16,000, while the Scottish and Irish note-issuing banks averaged about £16,000,000 for the same month. But though several of the Scottish and Irish banks¹ still possess the right to issue notes, and continue to do so, the other English note-issuing banks have lost this power because under the Bank Charter Act of 1844—the great legislative measure of Sir Robert Peel which regulates English banking—any English note-issuing bank which amalgamated with another bank immediately lost the right of note issue. Between 1914 and 1921 the remaining English note-issuing banks were absorbed by one or other of the big English joint-stock banks, and as a result they lost their old right of note issue.²

We must now return to the Currency and Bank Notes Act of 1928, under which the Bank of England and the Treasury notes have been amalgamated. This Act authorises the Bank to continue issuing its old notes of various denominations from £5 to £1,000, and, in addition, to issue 10s. and £1 notes, all of which are unlimited legal tender in Great

¹ The Banks of Northern Ireland must now be distinguished from those of the Irish Free State. The Irish Free State possesses a separate currency (see pp. 187-8, *infra*).

² Messrs. Fox, Fowler & Co., of Wellington, Somerset, absorbed by Lloyds in 1921, was the last of the English banks, other than the Bank of England, which possessed the right to issue notes.

Britain and Northern Ireland. The maximum fiduciary issue is fixed at £260,000,000, that is to say, the Bank is allowed to issue this total over and above the amount actually backed by the gold in the Bank's vaults, which, when the text of this Act was published on May 3, 1928, amounted to £159,315,980. The clause authorising this reads as follows :—

"Subject to the provisions of this Act the Bank shall issue bank notes up to the amount representing the gold coin and gold bullion for the time being in the Issue Department,¹ and shall in addition issue bank notes to the amount of two hundred and sixty million pounds in excess of the amount first mentioned in this section, and the issue of notes which the Bank is by or under this Act required or authorised to make in excess of the said first-mentioned amount is in this Act referred to as 'the fiduciary note issue.'"

Furthermore, the fiduciary maximum of £260,000,000 may, upon a request being made by the Bank, be increased by the Treasury for a period of six months, a period which under exceptional circumstances may be extended to two years. This is termed emergency currency, and the amount is left to the discretion of the Bank.

Prior to the passing of the Gold Standard Act in 1925 all Bank of England notes and Treasury notes were immediately convertible into gold. Under this Act, the Bank, as we have seen, was bound to sell to any person pure gold in bars, at the Mint price of standard gold, provided that a minimum of 400 ounces (troy) was required.

Thus, with the disappearance of the Treasury note British paper money now consists of two types: Bank of England notes, and the notes of certain Scottish and Northern Irish banks. The Scottish and Northern Irish notes do not

¹ The Bank of England is divided in two big departments: Issue and Banking. The business of the Issue Department is solely concerned with the issuing of notes and their metallic backing. For further details see pp. 217-220, *infra*.

circulate in England, are only partly secured by gold, and are regulated by two special Acts of Parliament passed in 1845,¹ under which these banks are allowed to issue notes in excess of their authorised issues, provided that the excess is backed by gold and silver coin in the issuing bank's possession. During the war period the notes of the Scottish and Irish banks² were made legal tender "for any payment" by the Currency and Bank Notes Act of 1914, a privilege which was discontinued on the first day of 1920. By July 1919 their average circulation had increased to over £30,000,000.

The Bank of England's note issue was increased between 1914 and 1928 by about £120,000,000. It therefore naturally follows that the gold in the Bank's vaults has increased enormously since 1914. But "The Old Lady of Threadneedle Street," to use the Bank's popular name, tells us in her weekly statement of accounts, which she calls "The Return," and which is issued to the eagerly waiting world of finance regularly each Thursday, that although she possesses in her closely-guarded vaults—guarded every night by the soldiers of a famous Guards regiment—gold worth many millions of pounds, she only keeps in what she calls her "Reserve" a small amount of gold.

Now by the "Reserve" the Bank of England means the last two items of the assets, described as "notes," and "gold and silver coin," in that part of the Return appertaining to the Banking Department.³ But we are not even told how much gold it contains. All that is stated is that the "gold

¹ 8 and 9 Vict. c. 37, An Act to regulate the Issue of Bank Notes in Ireland; and 8 and 9 Vict. c. 38, An Act to regulate the Issue of Bank Notes in Scotland.

² Up to the passing of the Irish Free State Act in 1922 the term "Irish banks" included both those of Northern Ireland and of the area now termed the Irish Free State.

³ See the copy of a recent Bank of England Return on p. 218, *infra*. The figures which follow with reference to the "Reserve" are taken from this particular Return.

and silver coin" in the "Reserve" amounts to a certain sum. On March 22, 1933, for example, this item amounted to £742,946, which may, of course, have been mostly silver. On the same date the "notes" in the "Reserve" amounted to £80,301,391. Thus the total of the "Reserve," or, in other words, all the coin and notes, or cash in hand, held by the Banking Department on this particular date was £81,044,337.

Three very important questions now arise. What does the Bank of England mean by announcing in its weekly Return published on March 22, 1933, that on this date it possessed in its "Reserve" "gold and silver coin" amounting to £742,946, when, in addition, on the same day it had gold coin and bullion amounting to £169,631,962 lying securely in its vaults? How is it that the Bank with £1,460,139 of "gold and silver coin" in its "Reserve" and gold coin and bullion amounting to £30,671,405 in its vaults on July 29, 1914,¹ managed to increase the latter item to £169,631,942 by March 22, 1933? Have the other English banks, such as Lloyds, Barclays, the Westminster, the Midland, the National Provincial, and Martins, no gold reserves?

These three questions are really not difficult to answer. The reserve of an ordinary business company is part of the profits set aside for emergency purposes. The Bank, of course, does this, but in its Return it gives the money thus held over out of profits the curious name of the "Rest," which is the reserve in the business sense, and is never allowed to fall below £3,000,000. What the Bank calls the "Reserve" an ordinary business company would call till money, that is to say, money or cash on hand which is always ready to meet the immediate demands of customers such, for example, as the cashing of Bank notes, or cheques. The Bank's so-called

¹ It must be noted that on July 29, 1914, the Bank's fiduciary issue amounted to £18,450,000.

"Reserve," therefore, does not form part of the big amount of gold coin and bullion in its vaults.

It is thus evident that the Bank of England's weekly Return, which will be examined in more detail in a subsequent chapter, contains some particularly interesting items.

The next two questions must now be briefly answered. The Bank's gold has increased because, in the first place, gold went out of circulation in 1914, and therefore the greater part of it found its way to the Bank's vaults; secondly, because during the war the British Government gave the Bank authority to commandeer the gold supplies of the Empire; thirdly, because the gold reserves of the other big English banks were transferred to the custody of the Bank; and, fourthly, because the Bank is now a bigger and more regular buyer of gold in the bullion market.

Thus, as gold coins are not now in general circulation in England, the other English banks keep very little gold in their strong rooms as a reserve. The other banks, however, do not call their own reserves "reserves," but refer to them in their periodical balance sheets under such descriptions as "cash in hand and at the Bank of England," or "coin, Bank, and currency notes, and balances at the Bank of England."

Finally, it is necessary to be quite clear about the meaning of the terms "currency" and "legal tender." Currency refers to the actual media of exchange such as coins, notes, cheques, bills of exchange, and interest coupons.

All these types, however, are not legal tender. Cheques, for instance, are not legal tender, yet over 90 per cent. of the total of payments made in England are made by means of these instruments which enable people to draw on their bank balances. Such a great use of cheques is the reason why a well-known banker like Mr. McKenna regards money in a country like England as "in the main bank balances."

Cheques, bills of exchange, and interest coupons are termed "instruments of credit" by means of which credit can be

transferred in the ledgers of bankers from one person's account to that of another. Legal tender is money which a creditor is compelled to take under the law of the land from a debtor. Sometimes the amount a creditor is compelled to take is limited; in Britain, for example, silver coins are, as we have seen, only legal tender up to a total of forty shillings. Sometimes the amount is unlimited as in the case of English gold coins, and Bank of England notes.

SUMMARY OF CHAPTER XIV.

The Definition of Money.—Marshall defines money as: "All those things which are at (any time and place) generally current without doubt or special inquiry as a means of purchasing commodities and services and of defraying expenses." But, as Mr. McKenna emphasises, money in modern communities is in the main bank balances.

The Functions of Money.—Three of the functions of money are—

- (1) A medium of exchange, or a means of payment.
- (2) A measure of value.
- (3) A standard of deferred payments.

Forms of Money.—The two great forms of money in circulation are—

- (1) Metallic; gold, silver, nickel, copper, and aluminium.
- (2) Paper.

Standard Money and Standard of Value.—From 1816 to 1914 the gold standard prevailed in Great Britain with the sovereign as the standard coin. This is termed monometallism, which must be distinguished from the double metallic standard (e.g. gold and silver) which is termed bimetallicism.

The gold standard was suspended in Britain at the outbreak of war in 1914, was re-established in 1925, and again suspended in 1931.

"Standard" money in Great Britain is therefore the sovereign; and gold is the "standard of value." A bimetallic country would have two standards of value.

Free and Gratuitous Coinage.—Before the passing of the Gold Standard Act in 1925 the British Mint was allowed to buy gold directly at £3 17s. 10½d. an ounce, and the coinage of gold coins was said to be "free and gratuitous"—"free" because any person was at liberty to send bullion to the Mint to be coined, and "gratuitous" because no charge was made for the work of coining. But since the passing of the Gold Standard Act all gold for coining goes to the Mint through the Bank of England.

The Bank and Market Prices of Gold.—The Bank price for gold eleven-twelfths fine (i.e. "standard" gold) is £3 17s. 9d. per ounce (troy), a price which is fixed by law.

The market price in pre-war days seldom varied much from £4 4s. 11½d. per ounce of pure gold. Since the war there have been many variations, and some very high prices were recorded after the financial crisis of September 1931. In France, Germany, and the United States "standard" gold is nine-tenths fine.

Silver Price Fluctuations, 1914-18.—The price of silver in England just before war was declared was 2s. an ounce. On August 12, 1918, a British Treasury order fixed the maximum price at 48½d. per "standard" ounce. Eight days later another such order fixed it at 49½d., a controlled price which lasted until May 5, 1919. In 1920 the average price was 7s. 5½d. per ounce. In the same year a special Coinage Act reduced the fineness of the silver in British silver coins from 925 to 500.

Paper Money.—Broadly speaking there are two classes of paper money—

(1) That which is fully backed by gold or silver. This is termed representative paper money, and is always convertible.

(2) That which is not fully backed by gold or silver. This may be convertible or inconvertible, and may have a partial metallic backing or no metallic backing at all. Notes issued without any metallic backing are termed fiduciary paper money.

The United States gold and silver certificates were examples of representative paper money.

British Paper Money.—British paper money is now composed of two types only—

(1) Bank of England notes (10s. to £1000) issued under the Currency and Bank Notes Act of 1928. A maximum fiduciary issue of £260,000,000 is allowed, and the remainder has to be backed by gold.

(2) The notes of certain Scottish and Northern Irish banks, which are partially secured by gold and are regulated by two Acts of Parliament passed in 1845.

The Bank of England Reserve.—The Bank publishes a weekly statement of accounts called the Return, and in this the last two items of the assets in the part relating to the Banking Department, which are described as "notes" and "gold and silver coin," are termed the "Reserve."

This so-called Reserve is mostly notes. It contains a comparatively small amount of gold. On March 22, 1933, for example, the "gold and silver coin" in the Reserve amounted to only £742,946, but on the same date the Bank had over £160,000,000 of gold coin and bullion in its vaults as metallic backing for its notes. The Reserve is really the Bank's till money.

Legal Tender and Currency.—Legal tender is money which a creditor is compelled to take under the law of the land from a debtor. In Great Britain sovereigns, half sovereigns, and Bank of England notes are legal tender to any amount.

Currency is the actual media of exchange, which in Great Britain consists of coins, Bank of England and Treasury notes, cheques, bills of exchange, and interest coupons.

CHAPTER XV.

MONEY (*continued*).

"Anything will serve for money, whatever its utility for other purposes, as long as we know that the seller from whom we want to buy will take it, either because he is in the habit of taking it, or because he is told by public authority that he must."—Hartley Withers. *Money*.

We have seen that the United States gold and silver certificates were fully backed by gold and silver. This is what is termed the simple deposit method of note issue. But these certificates, of which the gold ones were legal tender, only represented a comparatively small part of the paper money of the United States. There were five other types of notes in circulation. They were: the United States notes, commonly known as "greenbacks," which were legal tender, and secured by a gold reserve of 156 million dollars, and were redeemable at the Treasury; the Treasury notes of 1890, also legal tender and redeemable at the Treasury, but no longer issued; the notes issued by the National banks which were not legal tender; the notes of the Federal Reserve banks,¹ of which there have been no new issues since 1923, and which were backed by gold up to 40 per cent. of the amount outstanding and were redeemable at the Treasury or at the bank of issue, but were not legal tender; and the Federal Reserve notes, issued under the Federal Reserve Act, and which were redeemable at the Treasury or at any Federal Reserve bank, but were not legal tender.

Thus of the seven types of United States paper money three only were legal tender. The present circulation is given in the summary, page 196.

In France the paper money system is one of partial deposit.

¹The Federal Reserve banking system of the United States is described in Chap. XVIII., *infra*.

The Bank of France possesses a monopoly of note issue, and, in accordance with the French Stabilisation Act of June 1928, it has to keep a reserve of gold coin and bullion worth at least 35 per cent. of "the combined total of notes in circulation payable to bearer and of the credit balances of current accounts" (i.e. the balances of its customers which are withdrawable on demand). It is interesting to note that the Bank of France's gold and silver holding amounted on January 31, 1927, to approximately £236,000,000, which on that date was the largest in Europe and the second largest in the world.

In Germany, the re-constituted central bank, the Reichsbank, has been granted the monopoly of note issue with the exception of the limited rights of issue of four minor banks. During the post-war period, however, the Rentenbank was also allowed to issue notes, but under the Dawes scheme its issues have ceased, and this bank has been reconstructed as a mortgage institute. The notes of the Reichsbank must possess a backing of 40 per cent. gold or "devisen," of which not less than three-quarters must be gold. The term "devisen" is applied to "bank notes or bills of exchange having not more than 14 days to run, cheques and claims due from day to day payable in foreign currency by a bank of known solvency in foreign centres."¹

In Italy the Bank of Italy is the central banking authority, and since the end of June 1926 it has possessed the sole right of note issue. It must keep a metallic reserve—three-quarters of which must be gold—of 528 million lire² as a backing for its notes in circulation, and the normal circulation has been fixed at 7,000 million lire which can be increased upon payment of a tax to an absolute maximum of 8,000 million.

In Holland the Netherlands Bank is the great central bank. It possesses a monopoly of note issue and under a Royal

¹ Kisch and Elkin, *Central Banks*, p. 249.

² A lira is equivalent to 2.6d.

decree, which can be changed to suit special circumstances, was obliged to keep a metallie backing to its notes in circulation of at least 20 per cent. of the total amount.

Such were the paper money systems of the United States, France, Germany, Italy, and Holland. We must next glance at the methods of note issue in three of the British Dominions—Australia, Canada, and the Irish Free State.

Since 1920 the Commonwealth Bank of Australia has possessed a monopoly of note issue vested in a special department of the bank known as the Notes Board which publishes a periodical statement of the amount of notes in circulation. By law a gold reserve of at least 25 per cent. must be kept against the note issue, but since 1920 it has always exceeded 40 per cent. Notes may be issued for 5s., 10s., £1, £5, £10, or any multiple of £10.

The Canadian system is an interesting one, and is quite different from any of those that have already been described. "One of the striking features of Canadian banking," writes a prominent Canadian banker,¹ "is its system of note issues. Each bank (there are eleven at present)² is permitted to issue notes up to the amount of the paid up capital without special security, except as being a first lien on all the assets of the issuing bank. Provision is made to secure dollar for dollar all issues in excess of the limits just mentioned by deposits of gold or Dominion Government legal tender notes in the Central Gold Reserve, except in the case of certain excess issues subject to the payment of interest to the Government during the crop-moving months of the year. It is generally recognised that the amount of paper money in circulation should approximate, as nearly as possible, to that needed for the purposes of trade and industry. The Canadian

¹ Sir John Aird, President of the Canadian Bank of Commerce in *The Financial Times Canadian Supplement*, dated November 21, 1927.

² This refers to the chartered banks of Canada. These are described in p. 239 *infra*.

banks have authority to issue notes, and they control the supply of currency in this way; each bank seeks by the activity of its own business, to keep its notes in circulation, and almost daily it presents for redemption the notes of its competitors."

In Canada, therefore, both the Dominion Government and the banks are issuers of notes, the two types of paper money being termed Dominion notes and bank notes. The banks are allowed to issue their notes in denominations of \$5, \$10, \$20, \$50, and \$100. On any notes not backed by Dominion notes or gold they are required to pay a tax of 1 per cent. per annum to the Dominion Government, and on any excess issues during the crop-moving months a tax of 5 per cent. The issues of the Dominion Government include notes of lesser and higher face values than the bank notes. The Dominion notes range from \$1 to \$50,000, but the higher denominations, \$1,000, \$5,000, and \$50,000 are for the sole use of the banks as cash reserves and for clearing purposes.

Prior to the war the Canadian Dominion notes had to be backed by gold up to 25 per cent. of the first \$50,000,000 issued, with a dollar for a dollar gold backing on any excess of this total, while all the notes were redeemable in gold. But under the Dominion Notes Act of 1915 the total of notes against which a 25 per cent. backing was required was increased and convertibility was suspended.

The note issues of the Irish Free State are governed by the Currency Act of 1927, an enactment of the Dail. This Act set up a Currency Commission as the central authority for controlling the Irish Free State currency, and it provides for the issue of two types of notes: (1) consolidated bank notes, and (2) legal tender notes.

The consolidated bank notes are limited to a maximum issue of £6,000,000,¹ divided among eight Irish Free State banks,

¹ The Irish Free State pound is identical in weight and fineness with the British sovereign.

of which the Bank of Ireland possesses the right to issue a total of £1,705,000. These notes are uniform in appearance, but bear the name of the issuing bank. Each issuing bank is responsible for the conversion of the notes it has issued into legal tender at its head office, and has to give certain approved paper securities, such as bills of exchange, for the amount of its issue to the Currency Commission.

The legal tender notes are issued by the Commission to any person who offers in return gold or British legal tender equal to the face value of the notes received, and to any of the eight banks issuing the consolidated notes which offer bank drafts payable in London or British Government securities.

Such are the chief features of some of the paper money systems of the world. We have, however, not yet finished with paper money. We have still to consider two other types which, though they do not pass from hand to hand as freely as bank or Government notes, are very important forms of paper media. They are the cheque and the bill of exchange. The cheque is of paramount importance in Britain, and is, as already stated, far more frequently used in business transactions than the note, while it is gaining in popularity in other countries, particularly in America. The bill of exchange, on the other hand, is in universal use.

Both the cheque and the bill of exchange are negotiable instruments, that is to say, they can be legally transferred from one person to another, by delivery and indorsement. The bill of exchange is the customary form of making international payments, and is defined by British law as "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable time, a sum certain in money to, or at the order of, a specified person or to bearer." It therefore differs from a cheque because it may not only be drawn on a bank but also

on a mereantile firm, a merchant, or any other person. The following shows the usual form—

£2000.

London, June 30. 1927.

Three months after date pay to John Johnson, or order,
the sum of Two thousand pounds Value received.

To Messrs. Thomas Robinson & Co.,
Liverpool.

Robert Smithson.

In this example Robert Smithson is the "drawer." He has drawn the order on Messrs. Thomas Robinson & Co., and this firm is termed the "drawee," while John Johnson is termed the "payee," who is to be paid the £2,000 by the "drawee" three months after the date of the bill. The payee, however, would probably immediately sell the bill to a banker, or bill broker, for less than its face value, say, £1,980 in the above instance, and the buyer would then hold the bill until it was due for payment. This is what is termed discounting the bill of exchange. We shall return to this instrument in a subsequent chapter.¹

Now a cheque is also a bill of exchange, but it is a bill drawn by a person on a banker only, the drawer either having previously deposited money in the banker's charge, or having been allowed by the banker under a previous agreement and on the strength of certain securities to draw such cheques up to a certain sum, which is the banker's method of advancing money to a customer, or, in other words, of granting a customer credit. The money placed in the banker's care may be coin, notes, cheques, which the depositor has received from other persons as debt settlements, bills of exchange, and, also, in Britain, postal orders and post-office money orders. Cheques can be drawn up to the maximum of such deposits; if the banker allows the customer to exceed this maximum on the strength of securities, then the customer is said to receive an overdraft.

But although the cheque is recognised by the Bills of

¹ Chap. XIX., *infra*.

Exchange Act of 1882¹ as a bill of exchange, there are certain important differences. A cheque is always payable on demand, but the holder of a bill of exchange may have to wait a certain number of months before he can demand payment. Thus, as Mr. Hartley Withers has stated, "the element of time is the real outstanding quality in the bill of exchange which separates it from the cheque."²

But there is also another important difference. The cheque is taxed at the same rate whatever the amount of the sum it represents. It therefore has to bear a stamp, the price of which was raised from 1d. to 2d. in 1918³. The bill of exchange also has to bear a stamp, but its price varies with the amount of the bill, and there is a legal scale of charges, *e.g.* under £10, 2d.; £10 to £25, 3d.

The increase in the price of the cheque stamp has undoubtedly not only prevented people of small means opening up a bank account, but has to some extent restricted the use of cheques for payments of small sums among those who are fortunate enough to possess such accounts. This in turn has increased the use of notes and coins, a result which has been duly noted by the bankers. Indeed, some of the most prominent British bankers have strongly advocated that the cheque stamp should be reduced to the old charge of a penny, while some, notably Sir Drummond Fraser, have urged its total abolition.

And there are, of course, strong reasons for this reduction if not for the abolition. A reduction would certainly increase the banking habit; a greater use of cheques would reduce the use of coin and notes, and result in a *bigger mobilisation of credit* for the benefit of trade. It is therefore not surprising that one of the "Big Six" English banks recently attempted to encourage the banking habit among people of small means by introducing a plan for doing away with the cheque duty

¹ 45 and 46 Vict. c. 61.

² *Meaning of Money*, p. 38.

³ By the Finance Act of that year, 8 and 9 Geo. V. c. 15, section 36,

on small payments. Its customers were supplied free of charge with "books of receipts" containing a number of forms for the payment of sums under £2, and which did not require to be stamped. These "receipts" were very similar in appearance to cheques, and were worded thus—

This receipt must only be used for amounts under £2.

02110.....
Received of	
MIDLAND BANK LIMITED.	
.....Branch	
the sum of.....	
at the debit of (my) our account	
£.....	(Signature)

Immediately receiving the popular name of "chequelets" they actually functioned for a brief period in 1927, and could be presented for payment at the branch on which they were drawn, or handed to a tradesman or other creditor in settlement of debt. In this way, if, of course, we possessed an account at the Midland Bank, we could have paid our grocer, our purveyor of meat, our baker, and our tobaccoist such small sums as 2s. 6d., 5s., or 10s., just as simply as in coin or in notes.

Indeed, these receipts were not entirely a novelty when introduced by the Midland Bank for they had previously been used by some of the English provincial banks, only, however, for provincial drawings, and when thus used were not regarded as legally transferable. Therefore when this great bank proceeded not only to use them instead of coins or notes as payments to traders but also as negotiable instruments, the Commissioners of Inland Revenue decided to initiate a test case (*Midland Bank v. Commissioners of Inland Revenue*) in the King's Bench Division, which came before

Mr. Justice Rowlatt, who decided that "chequelets" were really bills of exchange and were therefore taxable under the Stamp Act of 1891. They were thereupon withdrawn.

The cheque is really an offspring of the bill of exchange. The latter instrument was in use in England at least two hundred years before the former was thought of. The early history of the bill of exchange is wrapped in obscurity; we do not even know when it was first used in England. There are, however, records of its use in London in the early years of the fourteenth century, and it was undoubtedly in use in at least one European country long before this. It was not, however, until the seventeenth century that cheques drawn on a banker were first used in England. Child's Bank, now amalgamated with Messrs. Glyn, Mills & Co., possesses the earliest known specimen which is dated 1670.

It appears that cheques were from the very outset regarded by the traders of Stuart England as bills of exchange. Therefore, as it was the custom of these traders to transfer bills of exchange from one to another, the cheque was, immediately it appeared, recognised under the "law of merchants" as a transferable instrument. The early cheques, or "drawn notes" as they were then called, were not stamped, and were simply small slips of ordinary paper on which the depositor wrote an order to his banker to pay a certain sum to another person. A cheque can still be made in this way provided that the maker affixes to it a 2d. stamp.

The cheque originated in England in the system of private banking conducted by the goldsmiths of later Stuart times, and so also did the bank note. "Some ingenious goldsmith," declares Mr. Hartley Withers,² "conceived the epoch-making notion of giving notes, not only to those who had deposited metal, but to those who came to borrow it, and so founded modern banking." But as the goldsmith bankers, the Bank of England, and the metropolitan and provincial banks that

¹ 54 and 55 Vict. c. 39. ² *The Meaning of Money* (1916 edition), p. 24.

were established in the hundred years following the foundation of the Bank of England, all issued their own notes, the use of the cheque did not make any striking progress until the nineteenth century. Its popularity was greatly increased by the Bank Charter Act of 1844,¹ which, as we shall see, forbade the foundation of any new banks of issue and strictly limited the notes of those banks that possessed the right of note issue. By this time, however, it had become quite evident to the trader that the cheque was far superior to the bank note as a means of remitting payments. Therefore it is not surprising to find a number of British legislative measures, such as the Bills of Exchange Act of 1882,² making the cheque a still better instrument by increasing its safety.

The enormous increase in the use of cheques in England is shown by the vast number that annually pass through the London Bankers' Clearing House, an institution which we shall return to later. In 1868 the total was £3,425,000; in 1914 it was £14,659,000,000; in 1918 £21,197,512,000; in 1927 £41,550,541,000; and in 1937 £42,686,309,000.

It is obvious from these figures that one outstanding result of the war was a big increase in the use of cheques. This was due in the first place to an enormous increase in deposits. The Government raised huge loans and the money thus raised was paid to its creditors, who in turn deposited the sums they received in the banks, and therefore had the right to draw a much larger number of cheques. In the second place the banks themselves allowed customers who offered good security to draw cheques in excess of their deposits. Big overdrafts were of frequent occurrence during the war period; the banks in this way greatly extended their credit. "So the banks which work with cheque-books," states Mr. Hartley Withers,³ "create credit and put money into circulation by giving to those who borrow from them a credit in their books, and

¹ 7 and 8 Vict. c. 32.² 45 and 46 Vict. c. 61.³ *Money* (1927), p. 39.

supplying them with books of cheques which they can draw in payment for anything they want to buy."

Now these big overdrafts allowed by the bankers were one of the causes of the great rise in prices in Britain during the war period. "By continuous lending," Mr. McKenna tells us,¹ "the banks can force up prices. Equally by continuously refusing to lend and restricting the amount of purchasing power banks can force down prices." The increased use of cheques as a result of an extension of credit, and the big issues of Treasury notes, were two of the great factors which brought about that phenomenon popularly termed inflation, but which, strictly speaking, should be termed monetary inflation.

It is thus clear that the monetary disease of inflation may arise either through an increase in the issue of paper money or through an extension of credit by the bankers. In, however, countries other than England, such as France, where the cheque system is not popular, inflation is primarily due to an excess of paper money. This excess is accompanied by an extension of credit, but not by a corresponding increase in production. Therefore, it may be stated that there is too much "paper" in relation to commodities produced. "It is important to note," writes Professor Kirkaldy,² "that an expansion in bank credit is not in itself an economic evil, for bank credit is absolutely essential to modern production. It is only when increased credit is not accompanied or followed in the near future by increased production (in quantity) that economic evils arise."

The amount of commodities produced in a particular country greatly affects the progress of an inflationary movement within its boundaries. Therefore, when a country suffering from inflation starts to reduce its paper money, and its bankers commence to reduce their credits, the production

¹ In the address on "Banking" already referred to.

² *British Finance, 1914-21* (1921), p. 275.

of commodities must also be increased in order that the process of deflation may more rapidly ensue.

Such is a brief account of the dangerous disease of inflation and its remedies. But there are two other diseases of money which also merit some attention. These, however, are confined to metallic money and are known as debasement and deterioration.

Debasement is a loss of purity or "fineness" in a coin as a result of an excess of alloy. Lowering the quality of the metallic content of silver coins has often been practised by English monarchs. The debasements of the coinage in Tudor times are outstanding events in the history of English currency. During the reign of Edward VI., for example, three ounces of pure silver and nine ounces of alloy were coined into £3 12s., of current coin of the realm. A more recent debasement of the British silver currency under the Coinage Act of 1920, which debased the silver coins from 925 fine to 500, we have already referred to.

Deterioration means a loss in the legal weight of a coin either through genuine wear and tear or through illegal clipping or filing. Clipping was particularly fashionable in England in the seventeenth century, and was one of the practices of the goldsmiths whenever bullion became dearer than coined money, and therefore the export of bullion became a very profitable occupation. But though the sovereign is not now circulated it is interesting to note that under British law this coin is allowed, when in circulation, to decrease in weight from 123.27447 to 122.5 grains. What is technically termed "the least current weight" of the British sovereign is therefore 122.5 grains (troy).

We must distinguish between the debasement or deterioration of a coin and the altering of a coin's value by Royal Proclamation. Thus in Henry VIII.'s reign, the value of an ounce of gold was enhanced under such proclamations from forty to forty-eight silver shillings, while the silver coins were

struck at the old purity but of diminished size. This is sometimes referred to as a debasement of the coinage, but there was really no alteration of the fineness or quality of the metallic content.

SUMMARY OF CHAPTER XV.

Paper Money Systems of other Countries.—The chief features of some of the important paper money systems may be thus briefly summarised—

(1) *The United States*: possessed seven types of paper money: gold certificates, silver certificates, United States notes ("greenbacks"), Treasury notes of 1890, National bank notes, Federal Reserve bank notes, Federal reserve notes. Since 1933 various changes have taken place in the American currency system. The present circulation consists of Federal reserve notes, United States notes, silver certificates, and some Treasury notes, 1890.

(2) *France*: a system of partial deposit. The Bank of France has a monopoly of note issue, and under the Stabilisation Act of 1928 it had to keep a minimum reserve of gold coin and bullion equivalent to 35 per cent. of "the combined total of notes in circulation and of the credit balances of current accounts." The franc has recently been devalued.

(3) *Germany*: the re-constituted Reichsbank has, with the exception of the limited rights of certain minor banks, been granted a monopoly of issue. The notes of the Reichsbank are backed by gold and "devisen" up to 40 per cent. of the total in circulation.

(4) *Italy*: the Bank of Italy is the sole note-issuing bank. It must keep a metallic backing—three-quarters of which must be gold—of 528 million lire, and the maximum issue of notes must not exceed 8,000 million lire.

(5) *Holland*: the Netherlands Bank possesses a monopoly of note issue and was compelled to keep a metallic backing of 20 per cent. of the total circulated.

(6) *Australia*: the Commonwealth Bank of Australia possesses a monopoly of note issue. A gold reserve of 25 per cent. of the total amount of notes in circulation must be kept.

(7) *Canada*: eleven chartered banks possess the right of note issue. The Dominion Government issues legal tender notes. Notes can be issued up to the amount of each bank's paid up capital without any special security except the assets of the issuing bank. A bank exceeding this limit must secure all additional notes with deposits of gold or

Dominion Government legal tender notes. Dominion notes have a partial gold backing.

(8) *Irish Free State* : possesses two types of paper money under the control of a Currency Commission—

(1) Consolidated bank notes issued by eight Irish Free State banks, each of which has to provide certain approved paper securities for the amount of its issue.

(2) Legal tender notes issued directly by the Commission to any person offering gold or British legal tender, and to any of the eight banks offering as security bank drafts payable in London or British Government Securities.

The Bill of Exchange.—The Bill of exchange is defined by British law as “an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable time, a sum certain in money to, or at the order of, a specified person or to bearer.” Discounting a bill means the selling of it to another person for less than its face value.

The Cheque.—The cheque is really a bill of exchange, but can only be drawn on a bank, whereas the bill of exchange can be drawn on a bank, a mercantile firm, a merchant, or any other person. The cheque is taxed at the same rate whatever the amount it represents, but the bill has to bear a stamp which varies in price with the amount.

A form of receipt termed a chequelet was introduced by the Midland Bank in 1927. It was declared illegal and was therefore discontinued.

Cheques were first used in England by the goldsmith bankers, and were originally termed “drawn notes.”

The returns of the London Clearing House are evidence of the enormous increase in the use of cheques in England. This increase is due to—

(1) An increase in deposits.

(2) The bankers allowing their customers to draw cheques in excess of their deposits (i.e. the granting of overdrafts).

The Diseases of Money.—The granting of overdrafts or extension of credit leads to *inflation*. Inflation is also caused by excessive issues of paper money, and by a decrease in production. It is one of the diseases of money. Other diseases of money are—

(1) *Debasement*, which is loss of purity or “finessness.”

(2) *Deterioration*, which is a loss in the legal weight of a coin.

CHAPTER XVI.

MONEY (*continued*).

"When we speak of the appreciation of gold, what we mean is, that in the countries using gold as the standard money, the general level of prices has become lower; in other words, that a given gold coin or a certain weight of standard gold will purchase more commodities—or conversely, that commodities will bring fewer pieces of gold."—J. S. Nicholson, *Money and Monetary Problems*.

Of the diseases of money which we have just discussed inflation is undoubtedly the most serious. We cannot, therefore, dismiss such a phenomenon with a cursory examination; its nature and extraordinary effects merit a more detailed analysis.

A great deal has been written about inflation and its remedies since the close of the war, and a great deal will be written about this phenomenon in years to come. It is the problem of what the economist terms the "depreciation" of money, which must be carefully distinguished from the debasement and deterioration—the depreciation through loss in purity or in weight—of the metallic content of coins which has already been explained. Paper money costs very little to produce, therefore, though many notes get soiled and are withdrawn from circulation we do not say that they have depreciated in content. By the depreciation of money—

either paper or metallic—we mean a lowering of purchasing power, and by appreciation an increase in purchasing power. In other words, depreciation means that the general level of prices has become higher, and appreciation that it has become lower.

The evils of inflation are many. "The primary outstanding evil of unstable money," states Professor Irving Fisher,¹ "is its disturbance of loan contracts. When there is inflation and prices rise the creditor loses and the debtor gains. When there is deflation and prices fall the debtor loses and the creditor gains." The rise in prices which accompanies inflation results in manufacturers, wholesalers, and retailers obtaining large profits during the rise simply by holding their stocks, which rapidly increase in market price. The enhanced profits of the capitalists and the increase in the cost of living result in social discontent and labour troubles. Costs of production quickly increase, an effect of inflation which is particularly detrimental to a country's trade, because it becomes increasingly difficult under inflationary conditions to compete effectively in the markets of the world. Wages rise, or more accurately, the nominal rate of wages rises, not the purchasing power or real income, but not so quickly as prices. And when deflation ultimately sets in, and prices begin to drop, wages again lag behind, a result which leads to unemployment. "Labour," declares Professor Kirkaldy,² "becomes so imbued with the money rate of wages, and not the real purchasing power of same, that discontent and strikes invariably arise later when the inevitable reaction in prices occurs and the increased wages cannot be maintained on economic grounds." The artificial prosperity which accompanies inflation undermines the economic life of a country and often leads to thoughtless extravagance, particularly among the profiteers.

¹ In an address to the School of International Studies at Geneva on "The Evils of Unstable Money," August 1927.

² *British Finance, 1914-21*, p. 285.

Hence when we speak of the deflation of an inflated currency we mean its "appreciation" or the increase of its purchasing power. Now, an increase in the purchasing power of money is the same thing as an increase in the value of money. And here we may appropriately discuss what has been termed the quantity theory of money, but in so doing we shall have to make use of what has previously been said about the theory of value, for the theory of value applies just as much to money as to any other commodity.

In its simplest form the quantity theory of money may be explained as the theory that general prices vary in proportion to the quantity of money in circulation. But there is a great deal more in the theory than this. We have already seen that the purchasing power of money may be measured by means of index numbers, and we have also seen that we may appreciate money by not only reducing the quantity of actual money in circulation but also by decreasing bankers' credits and by increasing output. It is therefore clear that monetary deflation, or, in other words, an increase in the value or purchasing power of money, may be brought about by certain important factors other than the reducing of the total amount of metallic and paper money in circulation. A country may, indeed, "appreciate" its money simply by increasing its output of commodities even if it does not decrease the quantity of money in circulation.

Thus when economists explain the quantity theory of money they take into account other factors besides the actual quantity of money in use, and consequently, they do not attribute a rise in prices solely to an increase in the amount of money in circulation. They also take into account the rapidity with which money circulates, and the effects of hoarding. Money which circulates very quickly, which changes hands with great frequency, affects prices much more than money which only changes hands occasionally. Rapid circulation tends to increase prices, while hoarding, of course,

lessens the actual quantity in use and therefore tends to lower prices.

The value of commodities other than money is expressed by their price, but in the case of money its value is expressed in terms of other commodities. The value of money is the quantity of other commodities for which it can be exchanged, that is to say, its purchasing power. It is, however, quite correct to speak also of the price of money, which may mean in a money market the current rate of interest at which loans may be obtained, or the current rate of discounting bills of exchange. It is customary for bankers and traders to talk of the "value" of money when they mean this to be its market "price," and not its purchasing power. We cannot apply the term price to money in the same way as we apply it to other commodities, for in the latter case price is, as we have seen, a money measure of value.

Clearly then, if the quantity of money remains stationary and the supply of commodities increases money will appreciate, while, on the other hand, if the quantity of money increases and the supply of commodities remains fairly stationary or decreases, money will depreciate.

But we have not yet finished with the problem of inflation. Let us consider the case of Britain, for example, where large sums of money are paid by the Government twice each year, on June 1 and December 1, as interest on the immense loans raised for carrying on the war. If, say, £50,000,000 is disbursed in this way on one of these dates, will not such a sudden increase in the quantity of money decrease its purchasing power? Will it not upset any attempts that may be made to gradually deflate?

These are very important questions concerning a section of monetary economics which to most people is an unexplored field. Under ordinary circumstances a sudden increase of this nature in the quantity of money would, other things remaining

the same, result in a certain amount of inflation. But in Britain, thanks to the activities of the Bank of England, any tendency to inflation after such big payments of interest is now counteracted in a very interesting way; not one of the recent disbursements has in any way interfered with the pound sterling's recovery.

The Bank's activities to prevent any inflationary tendencies after these disbursements are rendered easier because, in the first place, the date of the disbursement is known in advance, and, in the second place, because the British Treasury always gives the Bank any assistance that it may need. The Bank of England's big problem on these occasions is the elimination of the inflationary effects of the periodical payment of the War Loan interest, an operation which is carried out by means of a monetary instrument termed a Treasury bill. In order, therefore, to understand more clearly what exactly happens we must first of all examine this particular instrument.

Treasury bills are said to have been invented by Mr. Walter Bagehot,¹ the famous author of that classic description of the London Money Market, entitled, *Lombard Street*. In 1877 Bagehot urged the British Treasury to borrow money for short periods and to issue bills as security. This has been done regularly by the Treasury since 1877; previously it had been done, since 1696, by the Exchequer by means of the Exchequer bill which, however, is a different type of monetary instrument, for it carried interest, represented small sums such as £5 or £10, was always issued at its face value, and was passed freely from hand to hand. The British Treasury bill is never issued in denominations of less than £5,000, and never singly. The date of repayment is always given on the bill itself, which is of the following form:—

¹ Walter Bagehot (1826-77), economist and man of letters, was the editor of the *Economist* from 1860 to 1877.

Due 18th March, 19.....

TREASURY BILL

Per Acts 40 Vict., c. 2 and 52 Vict., c. 6.

London, 18th, Dec., 19.....

A

001706

£5,000

THIS TREASURY BILL entitles or
order to payment of FIVE THOUSAND POUNDS
at the Bank of England out of the Consolidated
Fund of the United Kingdom on the 18th day of
March, 19..... .

.....

Secretary to His

Majesty's Treasury.

Between April 1915 and April 1921 these bills were issued at fixed rates of discount, but since the latter date the old method of alluring potential lenders to tender for the bills has been used. When an issue is impending an announcement is inserted in the *London Gazette*, inviting tenders, say, for £40,000,000 worth of bills, which are divided up, among, or, in the language of the London Money Market, "allotted to," the various tenderers whose prices are highest, and for this reason the rate of discount under which the tenderers secure the bills varies.

During the war period, and just after, British Treasury bills were issued in large numbers, and were one of the causes of inflation, as the following figures will show. In December 1914 the total issued was £99,000,000; in December 1917 it was £1,058,000,000; and in December 1920, £1,102,000,000. The loans are quickly repaid, usually within a few months, when the bills are said to mature, therefore the debt is said to be "unfunded" or "floating"; and as in the case of War Loans the money raised is paid to Governmental creditors who

pay what they receive into the banks, thus swelling their deposits and giving the bankers further command over purchasing power.

From December 1920 the issues of British Treasury bills have been reduced, a reduction which was carried out rapidly up to December 1923, since when, though there has been a slight decrease, the total has not varied very much, and this is evidence of the British Government's attempt to keep prices fairly stationary. The Treasury bill is used in many countries.¹ It has never been used in Britain as legal tender, but it is interesting to note that such an instrument was made legal tender in Germany during the war period.

The British Treasury bill is issued on behalf of the Government by the Bank of England; the disbursements of interest on War Loan are also made by the Bank on behalf of the Government. Now the Bank, by inviting tenders for a larger number of Treasury bills than the average issue just before a big disbursement of War Loan interest is due, draws in money before the Government pays out. Or, in other words, the Bank is said to "tighten up" money before a disbursement, and, of course, in this way it manages to decrease the quantity in circulation, for Treasury bills are very popular in the City of London and are quickly bought up. Thus does the Bank counteract the tendency to inflation when the Government pays its interest on War Loan.

It is therefore quite evident that the Bank of England is particularly clever in the way it manages the issues of Treasury bills. But it has another device in connection with these bills which, like the one just discussed, always operates successfully. A short time before the disbursements are made it invariably shows great eagerness to buy up the bills already issued which are nearly due for payment. The more it buys, of course, the more money there is in the London Money Market to invest

¹ In France, for instance, there has been a great deal of inflation by means of Treasury bills or *Bons de la Défense Nationale*.

in the increased number of Treasury bills which are issued just before the disbursements, and so quickly are the new bills taken up that money becomes "tight" before the Bank proceeds to pay out the big amount of half yearly interest to the many thousands who financed Britain during the war.

We must now summarise the various danger signals which indicate that a country is over-issuing its paper money, and of which there are at least five. Prices begin to rise. Gold begins to disappear from circulation. Gold itself begins to rise in price, a rise which is due to the fact that the traders of those countries, which deal with the country possessing an inflated currency, demand gold in payment for the commodities which they sell, and this increased demand for gold immediately enhances its price. This in turn results in what is termed a lowering of the rate of exchange, a phenomenon which will be examined in a subsequent chapter,¹ but which, in the meantime, may briefly be described as a lowering in the foreign purchasing power of the money of the country which is suffering from inflation. Finally, if in a country with an inflated currency gold still circulates alongside of the paper money we may have a duplication of prices, a gold price and a paper price for the same commodities.

The over-issue of paper money during the war reached colossal dimensions, particularly in Germany. In pre-war manuals of economics the two classic instances of inflation usually discussed were the well-known "assignats" of France, and the "greenbacks" of the United States. The "assignats" were issued by the French Revolutionary Government of 1789-94 up to a total of 45,000,000 francs, and were secured by landed property which this Government had confiscated. They were from the outset over-issued, and in 1796 a 100 franc note was only worth 7 cents. The "greenbacks" referred to are not the modern United States notes.

¹ Chap. XIX., *infra*.

which are popularly called "greenbacks," but those issued in 1862 during the American Civil War. By 1864 these particular notes were worth 47 per cent. of their face value, and a little later only 35 per cent.

Both these famous issues, however, pale into insignificance when compared with the German war issue, which will be a classic instance for the economists of the future to discuss. The effects of such unlimited inflation are now well known. They were analysed in 1923 in a special Report prepared with great care by Colonel J. W. F. Thelwall, the British Commercial Secretary at Berlin, and published by the British Department of Overseas Trade. Colonel Thelwall emphasises that this colossal inflation resulted in the complete destruction of State credit, in the confusion of State finance, and in a great scarcity of credit facilities and a consequent high rate of interest. Furthermore, he points out that, when the German inflation was greatest, instances occurred of local authorities raising loans based on the value of rye, wheat, or coal, thus dispensing with the extraordinarily depreciated mark as a measure of value. The State of Mecklenburg, for example, raised a 40,000 cwt. rye loan at 5 per cent. It issued certificates for $\frac{1}{2}$, 1, 2, and 5 cwt., and fixed the annual interest on a certificate for 1 cwt. (100 German lbs.) as the equivalent of 5 lb. of rye in money.

No loans of this nature have been raised in Great Britain during or since the war. Nor was there such colossal inflation. Compared with Germany, or Austria, or Poland, the extent of the inflationary movement in Britain was comparatively small. The dollar equivalent of the British pound sterling in the United States never even dropped 50 per cent., while after the war the British Government gradually restored the pound sterling's purchasing power, until in the latter part of 1927 it was worth in the United States slightly more than the dollar equivalent of twenty shillings.

This brings us once more to the problem of deflation. How,

for example, did Great Britain manage after the war to increase the purchasing power of the pound sterling? Or, in other words, what methods were employed between 1919 and 1927 to bring down the general level of British prices? And this in turn leads to what is termed the stabilisation of prices, the bringing of prices down to a certain level and keeping them for a lengthy period somewhere very close to this level by avoiding, on the one hand, inflation, and, on the other, deflation.

First of all, as has already been stated, Great Britain greatly decreased the amount of Treasury notes in circulation. The regularly published Currency Note Redemption Account shows that these notes went on increasing in number even after the end of the war. In 1919 the number in circulation exceeded £367,000,000, but since the beginning of 1921 there has been a steady decrease. On March 30 of the latter year the number amounted to £343,000,000; by March 20, 1923, the total had dropped to just over £285,000,000; and by February 24, 1927, to just over £280,000,000.

In addition, bank credit was decreased, the output of commodities was increased, and war debts were honourably met, and as a result the world's confidence in the pound sterling was gradually strengthened. Ultimately, in 1925, Mr. Winston Churchill, the British Chancellor of the Exchequer, announced in his Budget speech that the British Government had definitely decided to return to the gold standard.

It was not, however, without a great deal of careful consideration that the British Government decided upon this step. In 1918 the famous Select Committee, of which Lord Cunliffe was chairman, had reported that, while the obligation to pay gold on demand should be maintained, it was not necessary or desirable that there should be in Great Britain an early resumption of the internal circulation of gold. Four years later the Financial Commission of the Genoa Conference, under the chairmanship of Sir Robert Horne, recommended

that there should be a return as soon as possible to the gold standard, and that the countries of Europe should aim at stability in the value (*i.e.* purchasing power) of their money.

There are two methods by which a country may stabilise its currency. It must either attempt to return to the old standard, to the old gold or silver coins of the same name and purity, or it must, as it were, start afresh and introduce a new gold (or silver) standard by issuing new gold (or silver) coins bearing the same names as the old coins but containing a lesser metallic content. The latter process is termed devaluation; the former, is, of course, deflation.

Thus if Great Britain had attempted to stabilise prices when the post-war purchasing power of the sovereign was, let us say, only equivalent to 14s., by coining new sovereigns containing only fourteen shillings' worth of gold and by making the paper pound equivalent to 14s., the process would be termed the devaluation of the pound sterling. This was the plan adopted by Poland in 1927, for the accomplishment of which the Polish Government raised an external loan of £2,000,000. The standard coin of Poland, the zloty, has been stabilised on a gold basis with a value corresponding to the average rate of its external purchasing power for the year preceding the date of the law authorising this change, and under a decree dated October 13, 1927, the zloty was given a gold value equal to zloty 8.9141 to the dollar.

Indeed, even in Great Britain, the question of devaluation was carefully examined by a special Treasury Committee appointed in June 1924 for the purpose of considering the feasibility of an immediate return to the gold standard. The idea of devaluating the pound sterling was rejected by this committee, because by 1924 the purchasing power of the pound sterling, as expressed in the currencies of the chief countries of the world, was in all cases almost up to its pre-war level. This committee also rejected the proposition that an attempt should be made to find a basis for British currency other than gold.

Thus Great Britain returned to its old gold standard on April 29, 1925, the day after the Government's decision to return was announced by the Chancellor of the Exchequer in his Budget speech. But what does this really mean? What actually happened?

In attempting to answer these questions it is necessary to remember that there are really three varieties of the gold standard. There are: (1) the gold exchange standard under which a country's currency is convertible into a foreign currency which is based on gold, or, in other words, that it can be changed into gold in the central bank of another country, and where the country with the gold exchange standard keeps a reserve; (2) the gold specie or full gold standard under which the paper money of the country concerned is immediately convertible into gold, gold coins are freely circulated, and bullion is bought and sold in open market without any restrictions; (3) the gold bullion standard, under which there is a free market of bullion and the central bank is allowed to use its discretion with reference to the buying and selling of bullion, but gold coins are not freely circulated, legal tender paper money being the customary medium of exchange. The third type was the one adopted in 1925.

In 1931, as a result of the financial crisis of that year which caused a big drain of gold from the Bank of England, the British Government decided to suspend the gold standard. This momentous decision was arrived at in a Cabinet meeting held on Sunday, September 20, 1931, a decision which was immediately followed by the passing of the Gold Standard (Amendment) Act on the next day. This Act, as we have already seen, has suspended the withdrawal of gold by members of the public from the Bank of England, which, under the Gold Standard Act of 1925, was allowed, provided a minimum of 400 ounces of pure gold was required.

In pre-war days the essence of the British system was the gold currency. Therefore the return in 1925 to the gold

standard as far as Great Britain was concerned did not mean a complete return to pre-war conditions. Then, again, before the war British credit expanded or contracted according to whether there was, as the result of payments abroad, a drain of gold. The extension or contraction of credit worked automatically. Now, however, there are different causes which affect the British Money Market. Take, for instance, the high disbursements of the interest on War Loans which occur twice a year, on 1st June and 1st December. One of these disbursements amounts to many millions, and this, of course, means that the resources of the Money Market are suddenly increased by a very large sum.

Therefore, as all the other British banks keep deposits at the Bank of England, and the Bank in its weekly Return includes the reserves of the other banks, and also the deposits of its other customers, under the heading of "Other Deposits," this item always increases just after 1st June and 1st December each year. It is the size of the "Other Deposits" at the Bank of England which influences British credit. When "Other Deposits" increases, then credit may be extended by the other banks, for they always regard what they have at the Bank of England as cash in hand and on the strength of these balances they are able to extend their credit.

SUMMARY OF CHAPTER XVI.

Inflation.—*Inflation* means the depreciation of money, i.e. a lowering of purchasing power. Its evils include—

- (1) A rise in prices.
- (2) Increased cost of production.
- (3) An artificial prosperity which leads to thoughtless extravagance.
- (4) Social discontent as a result of wages lagging behind prices.

When *deflation* (i.e. the appreciation of money, or the increase of its purchasing power) sets in, prices fall and wages again lag behind. This leads to unemployment.

The Quantity Theory of Money.—The quantity theory of money may be explained simply as the theory that general prices vary in proportion to the quantity of money in circulation. But economists in explaining the causes of a rise in prices also take into consideration such factors as the rapidity of the circulation of money, hoarding, bankers' credits, and the amount of commodities produced.

The value of money is the quantity of other commodities for which it can be exchanged, *i.e.* the purchasing power.

How Inflation Tendencies are Counteracted in Great Britain.—When a large amount of War Loan interest is disbursed the tendency to inflation is counteracted by the Bank of England's operations in Treasury bills.

The Treasury Bill.—These bills are issued by the British Government at a discount to the highest tenderers. During the war, and immediately afterwards, they were issued in very large numbers, and were thus one of the causes of inflation in Great Britain. Since December 1920 the issues have been greatly reduced.

The Bank of England issues the Treasury bills on behalf of the British Government, and also disburses the interest on War Loans. By inviting tenders, just before the interest disbursements are made, for a larger number of Treasury bills than usual the Bank draws in money, *i.e.* it "tightens up" money before a disbursement, and thus counteracts the tendency to inflation.

The Chief Signs of an Over-Issue of Paper Money.—These may be summarised as follows :—

- (1) A rise in prices.
- (2) A disappearance of gold from circulation.
- (3) A rise in the price of gold.
- (4) A lowering of the rate of exchange, *i.e.* a lowering in the foreign purchasing power of the money of the country which is suffering from inflation.
- (5) A duplication of prices.

Historic Instances of Over-Issues.—Two outstanding instances are—

- (1) The French "assignats."
- (2) The American "greenbacks." Both of these have now been eclipsed by such over-issues as the German and Austrian during the war. Colonel Thelwall's Report gives us valuable information about the results of German inflation.

Deflation.—How is deflation carried out? How, for example, did Great Britain manage during the post-war years to increase the purchasing power of the pound sterling? The methods adopted were—

- (1) Decreasing the amount of paper money in circulation.
- (2) Decreasing bank credits.
- (3) Increasing the output of commodities.

The Gold Standard.—As a result of the increase in the purchasing power of the sovereign Great Britain decided to return to the Gold Standard, i.e. the pre-war standard, in 1925, a return which had been recommended seven years earlier by the Cunliffe Committee.

In some countries, however, like Poland, a new value, less than the pre-war value, has been given to the standard coin. This is termed *devaluation*. France, Holland, etc., have recently devalued.

Three kinds of gold standard must be distinguished : these are known as—

- (1) The gold exchange standard.
- (2) The gold specie standard.
- (3) The gold bullion standard.

The third of these was operative in Great Britain from April 20, 1925, to September 21, 1931, when the British Government again suspended the gold standard by passing the Gold Standard (Amendment) Act. This was done because of a financial crisis which resulted in big withdrawals of gold by foreign depositors.

No country to-day is on a gold standard in the theoretical and nineteenth century sense. Almost everywhere, and especially in Europe, the foreign exchanges are controlled in various ways—by clearing agreements, etc.

[For further details about Great Britain's suspension of the Gold Standard in 1931 see Appendix 3, *infra*.]

CHAPTER XVII.

BANKS AND BANKING.

"Lombard Street, like the Court of St. James's, receives ambassadors from all parts of the world."—E. T. Powell, *The Evolution of the Money Market*.

Though the law of England specifies what bankers are not allowed to do, and gives them certain protections in the course of their business, it does not explain the meaning of the term "bank." There is no clear definition of a bank in English law, but it is interesting to note that the Finance Act of 1915¹ refers to a bank as an institution "carrying on a *bona fide* banking business," which, of course, is simply another way of stating that "a bank is a bank."² Any person, whatever his qualifications, is free to establish a bank in Great Britain or Northern Ireland. "It appears," states Dr. Leaf,³ "that it is open to anybody to take out at Somerset House a certain document known as a 'Banker's Licence'; it is only necessary to pay a fee, and no questions are asked as to the character of the business to be carried on under the licence."

Despite such legal looseness the English, Scottish, and Irish banks have developed into the safest in the world. They are, as is well known, not so old as certain European banks such as those of Genoa, Venice, Amsterdam, and Stockholm, all

¹ 5 and 6 Geo., V., Section 22.

² The Bills of Exchange Act of 1882 does not mention the term bank, but it states that the term banker "includes a body of persons, whether incorporated or not, who carry on the business of banking."

³ *Banking* (1926), p. 11.

of which were flourishing institutions when the Bank of England was established in 1694.

But there were banks in England even before the establishment of the Bank of England. English banking, which must be carefully distinguished from Scottish and Irish banking, originated in the activities of certain mercantile middlemen, such as the broker and the scrivener, who were important financial intermediaries even in Elizabethan times. There are documents which prove that the scrivener was recognised as a keeper of deposits so early as the reign of James I., and there are strong grounds for concluding that he functioned in this way even earlier. Indeed, as a deposit keeper, the scrivener appears to have preceded the goldsmith.¹

The goldsmith, however, appears to have been the earliest English banker to use the promissory note, in the first instance, as a receipt for actual coin deposited. Later, these notes were also issued to the goldsmith banker's customers in the form of loans, and therefore did not represent deposits. Then again, though the money deposited was originally payable on demand, as in the modern "current account" upon which a customer can draw at any time, the goldsmith banker was soon able to arrange that part of the money deposited could not be withdrawn unless a certain amount of notice was given. This was the beginning of what is now termed the "deposit account," under which a customer cannot withdraw any money without giving the banker at least a few days notice, often more, according to the agreement decided upon when the money is deposited.

It is quite clear from some of the surviving ledgers of the old goldsmith bankers that these bankers often required six days notice before deposits could be withdrawn, and that their customers frequently made use of cheques or "drawn notes."

¹ For further details about the beginnings of English banking see R. D. Richards, *The Early History of Banking in England* (1929).

Thus, when the Bank of England was opened in 1694 both the scrivener and the goldsmith were well established in England as bankers. The Bank from the outset was a joint-stock company, a corporation with a large number of shareholders. From the outset, also, it issued paper money known as Bank notes and Bank sealed bills, accepted deposits, and discounted bills of exchange. Its notes and sealed bills—the latter were soon discontinued—were issued against deposits and in the form of loans, and, like the goldsmiths' notes, passed freely from hand to hand. Indeed, until 1826 the Bank remained the only joint-stock banking company in England with the power to issue notes, but banks with partners of less than six persons—the so-called "private" banks—also possessed this power.

The London "private" banks increased in number and in strength during the eighteenth century and before the end of this century large numbers of English country banks had appeared, but during the Napoleonic war and the years immediately following many of these latter banks failed. Before the end of this century, also, the London banks had greatly developed the use of cheques, and, as a result, had gradually decreased their note issues. The provincial banks, on the other hand, made little use of cheques and relied chiefly on their notes.

The Bank of England's monopoly of joint-stock banking was due to a clause in the second Bank Act of 1697,¹ which forbade the establishment of a company of more than six persons for banking purposes, an enactment which was confirmed and made more rigid by later Acts. In 1826 banks owned by a partnership of more than six persons were allowed to be established outside a radius of sixty-five miles from London, and were given power to issue notes.² It is interesting to note that the last of the English provincial joint-stock banks which possessed the right of note issue—the Northampton-

¹ 8 and 9 Wm. III., c. 20.

² Under 7 Geo. IV., c. 46.

shire Union Bank Ltd.—lost this right in June 1920 on amalgamation with the National Provincial Bank.

The Act of 1826 was followed seven years later by an important Act¹ which allowed joint-stock banks to be established in London and the sixty-five miles radius, but such banks were not allowed to issue notes. The first of the Metropolitan joint-stock banks was the London and Westminster in 1831, and its establishment proved to be the beginning of a remarkable development of joint-stock banking in England, a development which has resulted not only in enormous joint-stock banking amalgamations, of which the "Big Six"—Barclays, Lloyds, Martins, the Midland, the National Provincial, and the Westminster—are easily the most powerful, but also in the almost complete disappearance of the old type of private bank.

Before, however, the joint-stock movement had made any great progress in English banking the Bank Charter Act of 1844² was passed, and as this is still the basis of the English banking system we must therefore examine it in some detail. This famous Act aimed at the extinction of the note issues of banks other than the Bank of England. The establishment of new note-issuing banks was forbidden, while the banks then issuing their own paper money were strictly limited to their average circulation for the twelve weeks immediately preceding the passing of the Act. The then note-issuing banks were to lose the power of issue upon amalgamation with another bank or when they ceased to issue through any cause, and the Bank of England was allowed to increase its own fiduciary issue, which the Act fixed at £14,000,000, by two-thirds of the amount of any of the other banks' note issues which lapsed.

But this process of extinguishing the note issues of banks other than the Bank of England took a much longer time than Sir Robert Peel and the supporters of the Act of 1844 antici-

¹ 3 and 4 Wm. IV., c. 98.

² 7 and 8 Vict. c. 32.

pated. It was not, as we have seen, until 1921 that the last of these note-issuing banks, Messrs. Fox, Fowler, of Wellington, Somerset, lost its power of note issue upon amalgamation with Lloyds. In the meantime, as the provincial note issues lapsed, the Bank of England's fiduciary maximum was gradually increased from £14,000,000 to £18,450,000, at which figure it stood when war was declared in 1914. During the war, however, although there were several lapsed issues the Bank's fiduciary total was not increased, and it was not until about two years after the absorption of Messrs. Fox, Fowler by Lloyds that two-thirds of the total of the lapsed issues during the war period was added to the Bank's pre-war fiduciary limit, making its total £19,750,000, the amount at which it stood when the Currency and Bank Notes Act of 1928 became law.

Such is the story of the lapsed issues. But the Bank Charter Act contains other features which are of the greatest importance. The Act placed the Bank of England itself on a better business footing, for it divided the Bank into two departments: Issue and Banking; and it was enacted that a statement of accounts must be issued weekly, the accounts of the two departments to be kept separate. Thus was originated the present Bank Return, which we have already partly examined, and which always appears in the English morning newspapers on Fridays.

The Return is, therefore, divided into two sections: Issue Department and Banking Department, and is published in the form shown on page 218.

A glance at the Return will show that we are given a number of totals under certain headings, with not much analysis of these totals. Take "Gold and Silver Coin," the metallic part of the Bank's so-called "Reserve." In the accompanying return it is given as £580,467, but, as already emphasised, this may, for all we know to the contrary, be almost entirely composed of silver coins. In "Other Deposits," which shows

THE BANK OF ENGLAND RETURN

Week ending February 2nd, 1938.

ISSUE DEPARTMENT.

£		£	
Notes issued :—		Government debt ...	11,015,100
In circulation ...	476,694,175	Other Government securities ...	188,021,697
In banking department ...	49,712,985	Other securities ...	954,677
		Silver coin ...	8,526
		Amount of fiduciary issue ...	200,000,000
		Gold coin and bullion	326,407,160
	<u>£526,407,160</u>		<u>£526,407,160</u>

BANKING DEPARTMENT.

Capital ...	14,553,000	Government securities	98,078,165
Reserve ...	3,591,268	Other securities:	
Public Deposits ...	11,404,084	Discounts and advances ...	10,478,552
Other Deposits:		Securities ...	18,671,625
Bankers ...	111,382,758	Notes ...	49,712,985
Other accounts	36,590,684	Gold and silver coin ...	580,467
	<u>£177,521,794</u>		<u>£177,521,794</u>

the total deposits of the Bank's private customers, a distinction is made between the deposits of the various banks (*i.e.* their reserves) and the deposits of the other private customers. This distinction, however, was only introduced into the Returns after the passing of the Currency and Bank Notes Act of 1928.

A humorous illustration of the cautious way in which the Return is drawn up is given by Dr. Leaf. "I was discussing," he states, "the Bank Return with the Governor of the Bank during the war, and mentioned that there was only one line of it which I thought I understood, 'Gold coin and Bullion.' The Governor, with a twinkle in his eye, replied, 'Mr. Leaf, I do not think you understand even that.'"

The Return itself, therefore, need not detain us long. All that is necessary is to give a very brief description of those items which we have not previously dealt with, and to compare some of the totals in the preceding Return with the corresponding items in a pre-war Return.

The items under the heading "Issue Department" simply give us the amount of notes in circulation and the total of the backing of "Government debt," "Other Government securities," "Other securities," Silver coin," and "Gold coin and bullion."

In the Banking Department section the first item on the liabilities side—"Proprietors' Capital"—is the Bank's fully paid up capital, and it never varies from £14,553,000. The "Rest," as previously pointed out, is a reserve fund made up of profits which is never allowed to drop below £3,000,000. "Public Deposits" are the balances of various Government departments including those of the Exchequer, the Savings Bank, and the Commissioners of the National Debt; the Bank manages all these accounts in its capacity as the banker of the State. "Other Deposits" we are already acquainted with. "Seven day and other bills" are what Mr. Hartley Withers terms "old-fashioned forms of remittance,"¹ sometimes referred to as "Bank post bills," which were introduced in the eighteenth century, when Hounslow Heath and Highgate Hill were infested with highwaymen, as a safer means of remitting money from London to the provinces than the actual transport of gold and silver.

On the assets side of the Banking Department section the item "Government securities" includes the Bank's investments in British Government stocks, while "Other securities" include loans to its customers and bills discounted. The last two items of the assets side of this section form, as we have seen, the Bank's "Reserve," or till money to meet any sudden demand. These two items are of the greatest importance.

The total enables us to gauge the Bank's strength. The

¹ This negligible item has not appeared lately.

proportion which the Reserve bears to the big liabilities known as "Public" and "Other Deposits" is a weekly index of the Bank's position. In the Return, which we have used as an illustration, it will be noted that the Reserve is about 31 per cent. of the total of "Public" and "Other Deposits." Before the war it was regarded as unsafe to allow this percentage to fall below 30 per cent., but since the war it has often been about 20 per cent., a percentage which is not now regarded as unsafe.

The remarkable increase in some of the totals of the Return since 1914 must now be noted. The following figures are taken from the Return dated July 29, 1914, which immediately preceded the outbreak of war:—"Notes issued," £55,121,405; "Public Deposits," £12,713,217; "Other Deposits," £54,418,908. These totals, as will be observed, are much less than the corresponding ones in the specimen Return dated February 2, 1938.

It will thus be seen that the Bank Charter Act of 1844 has resulted in wide publicity being given each week to the Bank's position, the key to which is the size of the Reserve compared with the size of Public and Other Deposits. As Dr. Leaf states: "The weekly Return is still a most valuable guide to the Money Market; before the war it was yet more valuable."¹

It must, however, be remembered that the Bank Charter Act with all its advantages was suspended during four financial crises—1847, 1857, 1866, and 1914—when, owing to big withdrawals from its gold bullion the Bank was given permission, by what is termed a "letter of licence" signed by the Prime Minister and the Chancellor of the Exchequer, to exceed its fiduciary limit. But as on three of these occasions—1847, 1866, and 1914—the panic was quickly allayed it was only in 1857 that the limit was for a short time exceeded.

The Bank of England is the centre of the English banking

¹ *Banking*, p. 35.

system; it is the bank of the Government and the bank of the other banks. It must also be remembered that just like the other banks it discounts bills of exchange, and makes advances to its customers. For these services it makes a certain charge, which it announces each week. This is known as the Bank rate, which may be defined as its lowest official rate for discounting bills and for advancing money on first class securities.

The Bank rate is higher than the market rate, which is the rate of the other banks for loans and for discounting bills, while the market rate, as has already been observed, is higher than the deposit rate. Moreover as the Bank rate is fixed each week it does not fluctuate, as the market rate does, in accordance with the supply of and the demand for bills. The Bank rate is fixed every Thursday by the Court of Directors and is never changed without the Court's permission. The Bank usually charges half per cent. more for loans than for discounting bills, and it discounts bills for its regular customers at the market price.

Now the importance of the Bank rate of discount lies in the fact that a rise or reduction of this rate is followed by certain immediate results in the London Money Market. A change in the Bank rate is usually followed by a change in the market rate. Since the war, however, the British Government, as we have seen, has made much use of the Treasury bill for raising short term loans, and as a result the price paid for these bills, or, in other words, their discount rate, is now an important factor in influencing the price of money in the open market.

But it must be noted that a rise in the Bank rate is still effective in increasing the supply of money. The raising of the Bank rate will attract money from abroad, and will diminish the demand for money for business enterprise at home. Such a rise is always followed by a rise in the deposit rate, and usually by a rise in the market rate. A lowering of

the Bank rate will result in a fall in the deposit rate, and also a fall in the market rate accompanied by an increase in borrowing by traders.

The raising or lowering of the Bank rate is, as has just been stated, entirely in the hands of the Bank's directors, and in making their decision they are influenced by the state of the Reserve, not so much by its actual total, as by its size compared with the size of the Bank's deposits, the proportion which it bears to deposits. If this proportion falls below a certain point then the Bank rate will almost certainly be raised. There are, of course, other factors which influence the directors such as a drain of gold for debt payments abroad, and such payments, particularly in connection with the war debt to America, have in recent years amounted to large sums.

Though, however, the Bank of England is the centre of the English banking system it must be remembered that most of the English banking business is conducted by the "Big Six" bank amalgamations, each of which possesses enormous resources. In the formation of these amalgamations we may distinguish two types of fusion: the absorption of a small bank by a big joint-stock bank, and the union of two large joint-stock banks.

The chief advantages of big combines of this nature are the great convenience to trade arising out of the extension of the area served by one big bank, and the larger resources of such banks. But there are also certain dangers, the most obvious of which are the reduction of competition, and the possibility of these powerful combinations developing into a "money trust."

As a result of the war, the amalgamation movement in British banking was greatly accelerated, and it was during the war period that the new type of amalgamation—the union of one powerful joint-stock bank with another—became so prominent. In fact, in 1917 and 1918 there were such striking amalgamations of this type that the British Government

decided in March 1918 to appoint a Select Committee "to consider and report to what extent, if at all, amalgamations between banks may affect prejudicially the interests of the industrial and mercantile community, and whether it is desirable that legislation should be introduced to prohibit such amalgamations or to provide safeguards under which they might continue to be permitted."

This committee carefully examined the main arguments for and against bank amalgamations. The members, who were well-known bankers and business men, gave particular consideration to the possibility of the development of one big banking combine or "money trust," which would not only undermine the central position occupied by the Bank of England, but would also place the financial safety of the country in the hands of a few individuals operating in the interests of the shareholders and thus neglecting the needs of industry and trade. The committee, though it did not believe that there was at the time any idea of actually developing a "money trust," came to the conclusion that the movement had proceeded far enough, and that the Government should forbid any further amalgamation unless previously approved by the Treasury.

As a result of this Report a legislative measure was introduced in April 1919 by the Chancellor of the Exchequer, but the Bill was withdrawn. The British Government has, however, since this date, forbidden any further bank amalgamations unless previously approved by the British Treasury.¹

It must be emphasised that all this amalgamation in British banking has been accomplished by fair means. There has been no "squeezing" of the smaller banks by the bigger ones. Take Lloyds, for example. With the exception of one

¹ In 1927 the British Treasury authorised one important amalgamation, that of the Bank of Liverpool and Martins and the Lancashire and Yorkshire Bank. The title of the combined institutions was shortened to Martins Bank.

private bank no rival bank has ever been invited to combine with this powerful amalgamation.

The history of Lloyds may serve as an illustration of the progress of British bank amalgamation. From 1863 this great bank has absorbed 53 other banks, and 22 of these since 1900. Some of the banks absorbed have been private firms and other joint-stock companies. The latter include the Worcester City and County Banking Company in 1889, the Birmingham Joint-Stock Bank in the same year, the County of Gloucester Bank in 1897, the Liverpool Union Bank in 1900, the Devon and Cornwall Banking Company in 1902, the Wilts and Dorset Banking Company in 1914, and the Capital and Counties Bank in 1918.

Side by side with the great development of amalgamation English banking has witnessed an enormous increase in the number of branch banks, and also, as already mentioned, a remarkable growth in the amount of deposits. According to the *Economist*¹ the deposits of the joint-stock banks of England and Wales (excluding the Bank of England) amounted in 1914 to £895,561,000, in 1921 to £1,974,898,000, in 1926 to £1,848,174,000, and £2,304,023,463 in June 1937.

But it must not be forgotten that the joint-stock banks of England and Wales include a number of big firms other than the "Big Six," while there are still a few private banks left, one of the latter, Hoare's Bank of London, dating back to pre-Bank of England times. Outside the "Big Six" there are such powerful and well-known banks as Messrs. Glyn, Mills & Co., Messrs. Williams, Deacon & Co., and the National Bank. These and the "Big Six," together with the famous old bank of Coutts & Co., which, however, is now affiliated with the National Provincial, are the ten great member banks of that remarkable institution known as the London Clearing House.

The London Clearing House was established by the London

¹ Banking Supplement, October 1937.

private bankers in the seventies of the eighteenth century as an institution for setting off the claims of various banks without cash payment. "It remains in its essence," writes Dr. Leaf,¹ "what it was at first, a meeting-place for the clerks of the various London banks; it has only three officers of its own, the Principal, Deputy, and Assistant Inspectors. The rest of the work is carried out by the staffs of the banks themselves."

It is here that the cheques drawn in one day, let us say on Lloyds and paid by Barelays, are balanced against the cheques drawn on Barelays and cashed by Lloyds. If the balance is in favour of Lloyds then this bank is credited with the balance in the "Clearing Bankers' Account" which is kept in the Bank of England. This is known as the "clearing" of cheques; the amount "cleared" in a year is a colossal one. The total amount for 1937 was, as we have seen, over forty-two thousand million pounds; a daily "clearing" is frequently over £127,000,000.

These figures are striking evidence of the development of the cheque system in England. The Clearing House has now three clearings: Town, Country, and Metropolitan, appertaining respectively to cheques drawn on the City of London offices of the banks, cheques drawn on country banks, and cheques drawn on metropolitan banks or branch banks outside the area of the City of London.

It must also be noted that the cheque system is well developed in the United States, where there is a similar kind of clearing; but in France the system has not made very great progress, and it was not until 1872 that a French Clearing House—the *Chambre de Compensation*—was established in Paris.

We are now in a position to examine in more detail the organisation of the London Money Market, often termed "Lombard Street," because this famous street is its chief

¹ *Banking*, p. 245.

artery. The centre of the system is the Bank of England. Then there are the "Big Six" joint-stock banks, and the other joint-stock banks with head or branch offices in the City of London; the issuing houses, such as Schröders, which specialise in the flotation of State, foreign, and company loans; the merchant banks, such as Barings and Rothschilds, which are also engaged in the flotation of loans, but whose chief business is connected with the accepting of bills of exchange, and are therefore known as accepting houses. It is interesting to note that the 1924 Czecho-Slovakian Loan of £1,850,000 was floated by Barings, Rothschilds, and Schröders, and the 1927 Republic of Poland State Loan of £2,000,000 by Lazard Brothers & Co.

Then come the London offices of the banks of the British Dominions and Colonies; the London offices of foreign banks; the discount houses and bill-broking firms, which specialise in the discounting of bills of exchange; the bullion firms; the insurance companies, which are of great importance because they are always investing money, often taking up large blocks of new loans, and also because they transact a great deal of overseas business and are therefore constantly receiving large payments from external sources; the private banks, which have almost disappeared; the savings banks; the Stock Exchange; the investment trust companies; and the Clearing House which, as we have seen, sets off the claims of the various banks.

Such is the structure of the London Money Market which, in spite of the setback of the war, is still the largest of its kind in the world. Some of the features just enumerated, however, merit further attention. The merchant bankers, for example, who accept bills of exchange and are of such importance in international trade, are really not bankers in the ordinary sense, for their customers do not draw cheques on them. The merchant bankers accept bills on behalf of traders upon whom they are drawn and whose names are not well known in

the London Money Market. For this they receive a commission, and the bill which they accept, or, in other words, become responsible for the payment of by indorsing their acceptance on the bill, is regarded as "first class." If, for instance, Barings, or Rothschilds indorsed an Argentine bill it would be discounted in any bank without question. The important feature of the merchant banker's business consists, as Mr. Hartley Withers states, of "examining the bills put before them for acceptance, keeping themselves well acquainted with the means and standing of the drawers of them, and giving their acceptance, for a commission, to such paper as fulfilled the requirements of their discrimination."¹

Then again, the discount houses are another striking feature which deserve a more detailed description. These firms are joint-stock companies whose chief business is termed bill-broking, a business which is also carried on by a number of private firms. Bill-broking is the discounting, or buying, of bills of exchange, their selling, and their holding until they are due for payment. The discount houses and the private bill-brokers buy the bills from the merchants, and they often sell large numbers to the banks. The best trade bills usually pass through the hands of the discount houses and the private bill-brokers, but it must be noted that since the war the English banks have greatly increased their discounting activities. Bill-broking requires a great deal of skill, and a particularly wide knowledge of a peculiar kind. "The discounteer," remarks Mr. Clare,² "must have the financial and moral standing of hundreds of commercial houses at his fingers' ends."

Furthermore, the business of bill-broking requires a great deal of ready money, therefore those that practise this profession are big borrowers from the banks, and the loans obtained for this purpose are always for short periods,

¹ *Meaning of Money*, p. 161.

² *A Money Market Primer*, p. 142.

what the banks term "call money," because they are liable to demand immediate repayment.

Among the London discount companies there are some very wealthy firms such, for example, as Alexanders, the Union Discount Company, and the National Discount Company. These companies are big joint-stock organisations, which not only conduct a large business in mercantile bills, but also in British Treasury bills, in receiving deposits for fixed periods or at call, and in granting loans upon approved securities.

Another important section of the London Money Market which, in view of its present position and future prospects, must be described in some detail, is composed of a number of very active organisations specialising in investments, the investment trust companies, which have made extraordinary progress since the war, and whose operations are being rapidly extended.

These trust companies are joint-stock corporations, which are managed by experts who act as the trustees of any money placed in their hands for the purpose of investment. The money is obtained from the public, who buy the company's shares in the open market, and in the form of temporary loans from the banks. Borrowing from the banks enables the trust company to take every advantage of any special opportunity for investing that may occur, and, moreover, avoids a fresh appeal to shareholders for new capital. The money in a trust company's hands is re-invested in a very large number of securities all over the world, and by a careful study of the various money markets the risks are greatly reduced and widely distributed.

The trust company is therefore invaluable to the small investor who cannot possibly be thoroughly acquainted with the big world of finance. Among the wealthier of these organisations are the Investment Trust Company, the British Investment Trust, and the Mercantile Investment General Trust, which were flourishing concerns before the war. Since

the war the investment trust companies have increased in number, and this type of business appears to have a promising future. "The investment of money to secure high rates of interest, coupled with reasonable security," writes Mr. Baillie Hamilton, in a report on the post-war investment trust companies,¹ "is by no means an easy problem, but this becomes more of an exact science with an investment trust company than with the average investor whose capital is limited, and to whom an error in judgment may be serious."

SUMMARY OF CHAPTER XVII.

The Development of English Banking.—There is no definition of a bank in English law. English, Scottish, and Irish banks are the safest in the world. They are, however, not so old as some of the continental banks, e.g. Genoa, Venice, Amsterdam, Stockholm.

But there were banks in England before the Bank of England was established in 1694. Brokers and scriveners were important financial middlemen even in Elizabethan times. The scrivener was recognised as a keeper of deposits in James I.'s reign.

The private banking of the goldsmiths was an important trade in the four decades preceding the foundation of the Bank of England. The goldsmith was the first English banker to use promissory notes.

The Bank of England from the outset issued promissory notes and sealed bills, accepted deposits, and discounted bills of exchange. The issue of sealed bills was soon discontinued.

Until 1826 the Bank was the only joint-stock banking company in England—a monopoly which was due to the second Bank Act of 1697. The private banks, however, were allowed to issue their own notes.

The Bank Act of 1826 authorised the establishment of joint-stock banks outside a radius of 65 miles from London.

The Bank Act of 1833 allowed such banks to be set up in London and the 65 miles radius, but they were not permitted to issue notes. The first of the Metropolitan joint-stock banks, other than the Bank of England, was the London and Westminster established in 1834.

The Bank Charter Act.—In 1844 the Bank Charter Act was passed. It forbade the establishment of new note-issuing banks. Those already possessing the right of note issue were not allowed to increase their

¹ The *Financial Times*, dated September 5, 1927.

issues above their average circulation for the twelve weeks immediately preceding the passing of the Act, but were to lose this right upon amalgamation with another bank, while the Bank of England was allowed to increase its fiduciary issue (which the Act fixed at £14,000,000) by two-thirds of the amount of the lapsed issues of the other banks.

The note issues of the other English banks were not extinguished until 1921.

The Bank Charter Act of 1844 divided the Bank of England into two departments: Issue and Banking, and enacted that a statement of accounts called "The Return" must be published weekly.

The Bank Return.—The Return is divided into two sections appertaining to—

(1) *The Issue Department*, which gives the number of bank notes in circulation and the amount of the metallic and other backing.

(2) *The Banking Department*.

The items in the second section—the Banking Department—may be briefly described thus—

(a) *Liabilities.*

Proprietors' Capital—the Bank's capital. It is fully paid and is fixed at £14,553,000.

Reserve—profits not yet distributed among the proprietors (i.e. shareholders).

Public Deposits—the balances of various Government departments.

Other Deposits—the balances of the Bank's other customers including the balances of the other banks.

Screen-day and other bills—bills issued by the Bank to its own customers.

(b) *Assets.*

Government Securities—the Bank's investments in British Government stocks.

Other Securities—includes bills of exchange and other securities for loans, and general investments.

Notes and Gold and Silver Coin—the Bank's till money, which is termed the Reserve.

The Bank Rate.—The Bank's lowest official rate for discounting bills is termed the Bank rate. It is higher than the rate of the other banks, i.e. the market rate, which, in turn, is higher than the deposit rate. The

Bank rate is fixed weekly by the directors, who in making their decision are influenced by the proportion of the Bank's Reserve to deposits. The market rate fluctuates in accordance with the supply of, and the demand for, bills.

A rise in the Bank rate increases the supply of money. It is always followed by a rise in the deposit rate, and usually by the market rate.

A fall in the Bank rate leads to a bigger demand for money. It will result in a fall of the deposit and the market rates.

Bank Amalgamations.—Two types of bank amalgamations may be distinguished—

- (1) The absorption of a small bank by a big joint-stock bank.
- (2) The union of two big joint-stock banks.

The advantages of bank amalgamations are—

- (1) The extension of a big bank's area.
- (2) The larger resources of the amalgamation.

The most obvious dangers of bank amalgamations are—

- (1) A reduction of competition.
- (2) The possibility of a big money "trust."

In 1918 the arguments for and against amalgamation were examined by a Select Committee appointed by the British Government, the members of which concluded that the amalgamation movement in British banking had proceeded far enough. As a result the British Government will now only allow such amalgamations that have been approved by the Treasury.

The history of Lloyds may be noted as an illustration of bank amalgamation. Since 1803 this bank has absorbed 53 other banks.

British banking has also witnessed a great increase in the number of branches, and a remarkable growth of deposits.

The London Clearing House.—Ten of the largest English joint stock banks are members of the London Clearing House, an institution for settling off the claims of the various banks without cash payments. The London Clearing House was established in the seventies of the eighteenth century by the London private bankers.

The London Money Market.—The chief elements of the London Money Market are—

- (1) The Bank of England.

- (2) The "Big Six,"¹ and the other joint stock-banks.
 - (3) The issuing houses.
 - (4) The merchant banks or accepting houses.
 - (5) The London offices of the banks of the British Dominions and Colonies.
 - (6) The London offices of foreign banks.
 - (7) The discount houses and bill brokers.
 - (8) The bullion firms.
 - (9) The insurance companies.
 - (10) The private banks.
 - (11) The savings banks.
 - (12) The Stock Exchange.
 - (13) The investment trust companies.
 - (14) The Clearing House.
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¹The "Big Six" are Barclays, Lloyds, Martins, the Midland, the National Provincial, and the Westminster.

CHAPTER XVIII.

BANKS AND BANKING (*continued*).

"The Federal Reserve Banks . . . are bankers' banks. Not only is their business mainly with the ordinary banks, as is the case with the central institution of other countries; but ownership is lodged in these their customers."—Taussig, *Principles of Economics*.

We must next glance at some of the other important banking systems of the world. We will take first the United States system.

Prior to 1914 the essence of American banking was decentralisation. Under the old régime the so-called "National" banks were, and still are, allowed to circulate notes on the security of Government interest-bearing bonds deposited in the United States Treasury, the issues being limited by the total face value of the bonds. Each National bank was, and still is, compelled to keep a special reserve against its deposits, and such reserves vary with the type of district served by the bank, the reserves of banks in big financial centres must be higher than those of the banks in less important centres. They were divided into three groups: the banks of three "central reserve cities," New York, Chicago, and St. Louis; the banks of "reserve cities," 47 large towns in 1913; and the banks of the smaller country centres, the "country banks." Those in the first two classes had to keep a reserve of 25 per cent. against their deposits, while in the third class the reserve was fixed at 15 per cent.

There was, however, an attempt at central control even

before the new system was introduced under the Federal Reserve Act of 1913. Under an Act of 1863 a Currency Bureau with a Controller of Currency was established at Washington. This was the central or national authority which had the power to authorise the establishment of banks by banking partnerships possessing a capital of \$100,000, upon such a partnership depositing in the American Treasury Government bonds equivalent in value to a minimum of one-third of their capital.

This explains the title "National" banks, that is, banks set up by a national authority. These banks were established under the authority of a charter granted by the Federal Government of the United States, and they must be distinguished from the "State" banks which were established under charters granted by a State government. In addition, there are several other types of banks in the United States, such as private banks, savings banks, land banks, and trust and loan companies.

Under the Aldrich Vreeland Act of 1908 the United States Government appointed a National Monetary Commission, whose members travelled all over the world, examined a large number of banking systems, and after nearly four years of thorough investigation, issued their report in January 1912, a report which resulted in the Federal Reserve Act of the following year.

The Federal Reserve Act re-arranged and centralised the banking system of the United States. The new Act did not abolish the National or any of the various State-chartered banks, and, though no great central bank, no "Bank of the United States," was established, a council of seven termed the Federal Reserve Board was set up at Washington as the central authority.

The Federal Reserve Board was composed of the Secretary of the American Treasury, who was the chairman, the Comptroller of the Currency, both of whom were *ex-officio* members,

and six other members appointed by the President of the United States with the approval of the Senate. The Act also established twelve principal banks, called Federal Reserve banks, for the purpose of serving the needs of twelve districts into which the whole country was divided. These, which are really great central banks, were established in New York, Boston, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Each has the right to establish branch banks. All the National banks, namely, those possessing a Federal charter, were compelled to become "members" of the particular Federal Reserve bank of their district, while the other banks were given permission to join the system as "member banks." Thus there is no central reserve in one institution as in the Bank of England. The "reserve" in the United States is distributed among the twelve great Federal Reserve banks; they are the banks of the other banks.

It must, however, be noted that out of approximately 30,000 banks in the United States only about 9,000 were, in 1932, members of the Federal Reserve organisation, but these 9,000 held about three-fourths of the total banking resources of the country. The outside banks were closely linked with the system through their transactions with the big city banks, practically all of which are members.

The Federal Reserve Board has many great powers. It is really an autocratic central authority possessing, for instance, the right to nominate three out of the nine directors allowed a Reserve bank, and it can even change any of the existing directors of such a bank. Moreover, the Board controls the notes issued to the Reserve banks, for they must apply to the Board for Federal Reserve notes, which are replacing the National bank notes and the Federal Banks' own note issues.

A Federal Reserve bank must, as we have seen, keep in gold a special reserve of at least 40 per cent. of the total amount of its own notes not yet withdrawn from circulation.

It has also to keep a reserve against deposits of not less than 35 per cent. of "gold and lawful money." The notes, though not legal tender, are accepted as tax and duty payments, and an issuing bank cannot pay out any notes which have been issued by another bank. The notes issued by one Reserve bank, which are received by another, must either be returned to the original issuer or paid into the United States Treasury for cancellation. Furthermore, the gold backing of 40 per cent. of the total notes issued, may be reduced by special permission of the Federal Reserve Board, and upon payment of interest, the rate of which is graded according to the amount of the deficiency.

The Federal Reserve system is therefore based on a proportional reserve below which no Reserve bank is allowed to go except upon payment of what is really a heavy tax. This is the method now in vogue in many countries. Take, for example, the system set up in Germany under the Dawes Commission, and afterwards modified by the London Conference. The 40 per cent. gold and "devisen" backing of the note issues of the Reichsbank may be reduced to 37 per cent. on payment of a tax of 3 per cent. upon the deficiency, and to 35 per cent. on payment of 5 per cent., while there is a sliding scale for further reductions.

The Reichsbank is a State bank, but it is independent of State control. It makes advances to the Government and keeps the Government's balances, but at the end of a business year the Government must not be indebted to it in any way. All the other big German banks, such as the Deutsche, the Darmstädter, the Disconto-Gesellschaft, and the Dresdner, are powerful commercial banks which specialise in the financing of industrial and commercial enterprises. They must be distinguished from the local public or savings banks of which there are a large number.

Similarly, in the Bank of France a special minimum gold reserve must, as we have seen, be kept. Like the Reichsbank

and the Bank of England, the Bank of France is a private undertaking and a great central reserve bank. Its Governor and two Deputy-Governors are appointed by the French Government, and three of its fifteen "regents," who are elected by the two hundred largest shareholders, must be Treasury officials. The Banque de France was founded in 1800 by Napoleon, and its organisation has remained unaltered since 1808. It acts as banker to the Government, issues Treasury bills, and discounts bills of exchange, but does not pay interest on deposits. It has over 250 branches of which 18 are in Paris.

The French banks are, like the German banks, much more closely connected with industry than the British banks are, and they also concentrate more on the business of discounting bills of exchange. Outstanding examples are the Banque de l'Union Parisienne, which has big interests in the electrical and metallurgical industries, the Banque Nationale de Crédit, which does a great deal of business in connection with the flotation of new industrial enterprises, and the Comptoir National d'Escompte de Paris, which has specialised in the financing of railway construction.

The French system, again, may be compared with that of Australia. The Commonwealth Bank of Australia, which was established in 1911, by a special Act of the Commonwealth Parliament, is a great central bank, owned and guaranteed by the Commonwealth or Federal Government, with branches in the chief Australian towns and two London offices. Its Governor and seven directors are appointed by the Governor-General of Australia. It is the first Government-owned bank to be established in the British Empire, and it acts not only as the bank of the Commonwealth Government but also of the Governments of the States of Queensland, South Australia, and Tasmania. It is, therefore, both a Federal and a State bank because it is the bank of the central Government and of the Governments of certain individual states.

This great central institution possesses a striking feature in its Savings Bank Department, which has branches in the chief towns and in over 3,000 Australian Post Offices. Its Note Issue Department has already been referred to. It is under the control of a board of directors appointed by the Federal Government, and prior to 1920 was managed by the Federal Treasury. There is, however, an important safeguard with reference to the bank's paper money. The Governor-General has power to transfer the control of the note issues to the Federal Treasury whenever he considers that an emergency has arisen.

The Commonwealth Bank of Australia is thus a great central bank which has sole control of the only paper currency now in use in Australia. It carries on a big commercial banking business through a large number of branches scattered all over the Australian continent, accepting deposits, making advances by way of loan or overdraft, discounting bills of exchange, and even acquiring and holding land.

The central banking experiment of Australia was followed in 1921 by a similar experiment in South Africa, when this Dominion established a reserve bank, and selected its first Governor from the staff of the Bank of England. The South African Reserve Bank has, since the beginning of 1927, kept the Union Government's balances which previously were distributed among some of the other South African banks, and, under an agreement made in 1926 with the Gold Producers' Committee of the South African Chamber of Mines, it undertakes to buy at a fixed price all the fine bullion which the producers offer to it. It possesses the sole right of note issue in the Union of South Africa, and 40 per cent. of the amount of its notes in circulation must be secured by gold.

But central banking has not yet been adopted by the other great British Dominions. In New Zealand, for instance, though the Bank of New Zealand controls 40 per cent. of the banking business and functions as the bank of the Government

it is not a central bank. The Bank of New Zealand is a private institution. The Government, however, holds one-third of its shares, and has the power to appoint four out of its six directors, the remaining two being selected by the ordinary shareholders.

In Canada, also, there is no central bank, nor under the present Canadian banking system does there appear to be any special need for one. Canada is fortunate in possessing a number of very efficient chartered banks of which the Bank of Montreal is the recognised leader. These banks are, as we have seen, eleven in number, and, under recent legislation, their books must be regularly inspected by Government inspectors, and their accounts audited by independent chartered accountants. In addition, no new bank can be established in Canada unless the actual subscriptions of its capital amount to \$500,000, of which \$250,000 must be deposited with the Canadian Minister of Finance.

A Canadian chartered bank has been described as "a bank of branches, not a bank with branches,"¹ because the real banking business is done by the branches. The head office does not grant loans or accept deposits, its work is confined to the control and supervision of the branches, which are not limited to Canada. The Bank of Montreal, for example, has branches in Newfoundland and the United States, the Royal Bank of Canada in Bolivia and Venezuela, and the Canadian Bank of Commerce in the West Indies, Mexico, and the United States. Five of the Canadian chartered banks have branch offices in London.

Central banks, however, are the more prevalent type among the chief countries of the world. The banking systems of the two wealthiest countries—the United States and Great Britain—are, as previously explained, based on the principle of centralisation, for though the United States has no great

¹ Mr. James Ogle on the Canadian banking system in *The Times Trade and Engineering Supplement*, dated 18th June, 1927.

activities to the supply of credit in their own countries, but should co-operate with one another for the better regulation of the flow of gold from country to country, and the transferring of credits. A certain amount of co-operation has already taken place with beneficial results, and there is no doubt that the financial recovery of Europe since the war is, to a great extent, the result of the help organised by the Bank of England in co-operation with the Federal Reserve Board. "There is, in fact," declares Mr. Kiddy,¹ "a similarity between the aims and objects of the League of Nations and those of the informal league of international banks. Like the League of Nations, international bankers, by the very nature of their operations, are disposed to think internationally as well as locally, and are better able than many in their respective countries to perceive that the seeking of the good of all is usually the best policy to be pursued even for their own particular country."

SUMMARY OF CHAPTER XVIII.

The United States Banking System.—Various legislative changes took place in this system between 1933 and 1936. The Act of 1933 removed all gold from circulation and amended the Federal Reserve Act. The Act of 1935 removed the Secretary to the Treasury and the Comptroller of the currency from the Reserve Board. The title of the Board was also changed. The present currency circulation is given in the summary of Chapter XV.

The German Banking System.—This is a system of central banking. The Reichsbank functions as the national reserve bank, but is independent of the State in theory. In practice it is controlled by Hitler's party.

The French Banking System.—Here the Bank of France is the great central reserve bank. It keeps the Government balances, but is a

¹The *Spectator*, dated July 23, 1927.

private undertaking. It has many more branches than the Bank of England. The French banks are much more closely connected with industry than the English banks.

The Australian Banking System.—In 1911 the Commonwealth Bank of Australia was established as a central reserve bank guaranteed by the Commonwealth Government. It is the bank not only of the Commonwealth or Federal Government, but also of the Governments of Queensland, South Australia, and Tasmania. Its Savings Bank Department is one of its important features.

The Australian note issues are controlled by this bank's Note Issue Department.

The South African System.—This has been centralised by the establishment of the South African Reserve Bank in 1921, which keeps the balances of the Union Government. It possesses the sole right of note issue in the Union of South Africa.

The New Zealand System.—New Zealand does not possess a central bank. The Bank of New Zealand functions as the bank of the Government, but is a private institution. One-third of its shares are held by the Government, which has the right to appoint four out of its six directors.

The Canadian System.—Canada has eleven great chartered banks, of which the Bank of Montreal is the recognised leader, but no central reserve bank. These chartered banks have numerous branches; some have branches in other parts of the American continent; five have London offices.

Central Banking.—The chief functions of a central bank may be summarised as follows :—

- (1) The custody of a country's gold or exchange reserve.
- (2) The custody of the cash reserves of the other banks.
- (3) The regulation of a country's note issue either by being the sole bank of issue or the bank which issues the greater part of a country's paper money.
- (4) The control of a country's credit.

Central banks may also act as Government banks by keeping the balances of the State.

The co-operation of central banks is important from the standpoint of international peace.

CHAPTER XIX.

FOREIGN EXCHANGE.

"We may describe Foreign Exchange as the business of exchanging currencies, or as the study of the way in which currencies are exchanged."—H. C. Walter, *Foreign Exchange and Foreign Debts*.

"The foreign exchanges are the index of the international value of money, the value in one country of a debt payable in another, and of the conditions governing the transmission and settlement of such debts."—E. Sykes, *Banking and Currency*.

Foreign exchange is usually regarded by the general reader as a tedious and complicated section of economics, where the pitfalls are many and the labyrinths long and mysterious. It is true that certain difficulties will be encountered in studying this important subject, but it must be emphasised that they are neither so numerous nor so troublesome as they are generally thought to be.

It is, in the first place, obvious that international trade would have to be carried on by bartering unless the traders of one country were able by means of certain media to settle their debts in another country. But though we possess the necessary media for the settlement of international debts we must also be able to estimate the purchasing power of the currency of one country in terms of another. It is with the comparisons of the purchasing power of the currencies of nations that foreign exchange is concerned.

The most frequently used instrument for settling international debts is the bill of exchange. But such debts may

also be settled by means of gold, if, of course, there is no embargo on its export from the debtor country. Then again, bank drafts in foreign currencies, such as drafts for so many dollars in settlement of an American debt, may be sent. These can, as will be seen a little later, be bought in banks which possess balances in the country to which the remittance is to be sent.

Nor are these three methods the only ones. A draft in the home currency may be sent to a foreign creditor. Thus, for example, British Post Office money orders or sterling drafts, which entitle the holder to so many pounds, are frequently sent from Great Britain to other countries, particularly America, in settlement of debts, and these orders and drafts are changed into the currency of the country concerned by the creditor's own bank.

Another method is the sending of interest coupons to a foreign creditor. Such coupons on the bonds of another country would be immediately accepted in settlement of a debt in the country issuing the bonds, and also in many other countries, and they are, therefore, frequently used for settling international debts.

And there is yet another method of remitting money from one country to another. A merchant may keep an account in one of the banks of the country with which he trades, and settle any debts in this particular country by drawing on his account. Americans frequently settle their English debts in this way by drawing cheques on their balances in English banks, and Englishmen often send their American creditors cheques drawn on American banks.

Of these media, by means of which international debts are settled, two are of such outstanding importance, and are so closely connected, that they must be examined in more detail. These are the bill of exchange and the banker's foreign currency draft.

There are two types of bills of exchange: the inland bill,

drawn and payable within a country and used in connection with its internal trade, and the foreign, or "outland" bill, the instrument so indispensable to the external trade of a country, and which is drawn in one country and payable in another.

Now, as we have seen,¹ a bill of exchange is an order, payable on demand or in a certain fixed period, made by a creditor to a debtor in which the former, termed the drawer or maker of the bill, instructs the latter, termed the drawee, to pay a sum of money to himself, or to another person, termed the payee. A drawee is termed an acceptor after he signifies that he is willing to pay the bill by writing on it his signature, which is usually accompanied by the word "accepted" and the name of the bank where the bill is payable.²

If a bill is drawn "at sight" it is termed a "sight draft," and must be paid as soon as it is presented for acceptance, but more frequently bills are drawn at 60 or 90 days' sight. Thus, if a bill commences with such a phrase as: "Ninety days after sight . . . pay . . ." it means that the 90 days run from the date the bill was "sighted" or presented for acceptance, while such a phrase as: "Three months after date" means that the period specified commences with the date of the bill. Three days' grace, however, are always allowed in each case. A sight draft requires only a 2d. stamp, but all other bills have to be stamped *ad valorem*.

A bill of exchange is an instrument which can be passed from hand to hand. Any person who takes the bill in this way is entitled to payment. If, for example, Z sells a bill accepted by Y, he writes his name on the back of the bill. This is termed an indorsement "in blank,"³ and though the

¹ See pp. 188-9, *supra*.

² The following acceptance shows the usual form: "Accepted payable at Lloyds Bank, Cambridge, Thomas Robinson & Co."

³ This refers to a bill payable to order. If a bill is made payable to bearer no indorsement is necessary because in this case the bill passes from hand to hand by mere delivery.

acceptor *Y* is liable on the bill if he fails to pay when the bill is due, the person who holds the bill can sue either *Y* or *Z* or any other person who has indorsed the bill.

An indorsement, however, may be of a special nature. *Z* may not only indorse a bill by simply writing his name on the back, but he may also make the bill payable to a definite person by writing on the back thus: "Pay *B* or order," and then adding his signature. In this case the bill cannot again be negotiated unless *B* indorses it, that is to say, unless it is given an indorsement in blank. Bills indorsed in blank can be transferred from hand to hand without any additional indorsement. Such bills are, therefore, transferable by mere delivery.

We are now in a position to examine the nature of a transaction in foreign bills of exchange. Suppose that John Robinson, an English merchant, sells to De Morer, a Bordeaux importer, cotton goods worth 25,000 francs. Robinson exports the goods, draws a 90 days' bill of exchange on De Morer for 25,000 francs payable to himself or order, and forwards the bill and the shipping documents to his agent in Bordeaux, who gets De Morer to accept the bill.

After De Morer's acceptance has been secured there is more than one method of dealing with the bill. It may be immediately discounted in France by Robinson ordering his agent to sell the bill to a French bank. It may, on the other hand, be returned to Robinson, who may then either hold the bill until its maturity at 90 days after its date, or sell it to a bill broker.

If the bill is sold to a bill broker this specialist may in turn sell it to an English bank, and thus give the bank power to draw drafts on its French agents. A bank possessing a number of such bills of exchange drawn on French importers would, by sending them to its French agents to await maturity, be in a position to enable its customers to remit money to France. The money would be remitted by the bank drawing

drafts on its French agents, and selling these drafts to its customers at prices which vary for reasons which will be explained later. The bank's customers could then send these drafts to France as debt payments.

But there is yet another way in which a bill of this nature may be dealt with. Robinson may hand the bill of exchange to his bank with authority to collect the amount specified when payable, and credit his account with the same. Upon receiving the bill the bank would send it to its agents in Bordeaux who would obtain De Morer's acceptance, and then hold the bill until its maturity. Immediately payment was secured they would inform Robinson's bankers in England, who would thereupon credit Robinson's account with the English, or sterling as it is termed, equivalent of the 25,000 francs.

This brings us to the next problem, a problem which needs very careful examination. How is the sterling equivalent of the francs arrived at? How do we know the relative value of the sovereign and the franc, the dollar and the franc, or the mark and the franc? "Here," states Mr. Withers,¹ "comes the difficulty. When it is a matter of payment between London and Sydney there is no question of a difference in currency—the sovereign is the unit in both places. But when a draft on London has to be sold in America the relative value of the sovereign and the dollar comes into calculation."

Now in comparing currencies gold is the measure, because gold is the recognised international currency. The comparison is based upon the weight and fineness of the gold contained in the standard gold coins of the countries concerned. It depends, of course, upon the Mint regulations of each country, and it expresses the exact relationship between the metallic contents of the standard coins.

By this means we know the rate at which the standard coin of one country can be exchanged for the standard coin of

¹ *The Meaning of Money*, p. 176.

another on a fixed metallic basis. This is termed the Mint par of exchange, often referred to briefly as par. "The Mint par of exchange," writes Mr. Spalding,¹ "may be best described as the rate at which the standard coin of one country is convertible into that of another country according to the terms of their respective Mint laws."

As an illustration we may calculate the Mint par between the United States and England, between the nine-tenths fine American golden eagle and the eleven-twelfths fine British sovereign, thus—

Weight of the British sovereign = 113·0016 troy grains of pure gold.

Weight of the U. S. golden eagle (\$10) ... } = 232·2 troy grains of pure gold.

$$\therefore \text{£1} = \frac{113\cdot0016}{232\cdot2} \text{ of an eagle ;}$$

$$\therefore \text{£1 (as the dollar is } \frac{1}{10} \text{ of the eagle) ... } = \frac{113\cdot0016 \times 10}{232\cdot2} \text{ dollars,}$$

$$\text{i.e. £1} = 4\cdot8665 \text{ dollars.}$$

The London-New York or sterling-dollar Mint par of exchange is therefore 4·8665.

Such is the method of comparing the currencies of two countries whose standard coins are gold. If, however, in one of the countries, say Great Britain, the standard coin is gold, and in the other, say China, it is silver, there can be no fixed relationship or Mint par between these two countries, and the rate of exchange depends on the fluctuations of the market price of silver.

But if one of two countries whose currencies we are comparing possesses a paper currency with a nominal gold unit, then the Mint par of the gold unit must be calculated and changed into terms of paper money by finding the number of

¹ *Foreign Exchange and Foreign Bills in Theory and in Practice* (sixth ed. 1925), p. 14.

units of the paper money equivalent to the gold unit. And so, also, if one of the countries has a silver currency and a nominal gold unit, we must follow a similar method of calculation in arriving at the Mint par of exchange between this particular country and a country possessing a standard coin of gold.

Having thus considered the meaning of the term Mint par of exchange, we may now turn to the list of exchange rates which appears in our morning paper. The following quotations, which are selections taken from this list, are from *The Times*, dated February 1, 1938.

Place.	Method of Quoting.	Par of Ex- change.	January 31st	January 29th
New York ¹ ...	\$ to £	4.86 $\frac{2}{5}$	5.00 $\frac{1}{4}$ —5.00 $\frac{1}{2}$	5.00 $\frac{1}{2}$ —5.01
Montreal ...	\$ to £	4.86 $\frac{2}{5}$	5.00 $\frac{1}{2}$ —5.00 $\frac{1}{2}$	5.00 $\frac{1}{2}$ —5.00 $\frac{7}{8}$
Paris ...	Fr. to £	124.21	152 $\frac{1}{2}$ —153 $\frac{1}{8}$	152 $\frac{1}{2}$ —153 $\frac{1}{8}$
Brussels ...	Bel. to £	35.00	29.61—29.63	29.60 $\frac{1}{2}$ —29.62 $\frac{1}{2}$
Milan ...	Lire to £	92.46	95—95 $\frac{1}{8}$	95—95 $\frac{1}{2}$
Madrid ...	Pts. to £	25.22	70—110	70—110
Lisbon ...	Escu. to £	110.00	110—110 $\frac{3}{8}$	110—110 $\frac{1}{8}$
Amsterdam ...	Fl. to £	12.11	8.96 $\frac{1}{2}$ —8.97	8.96 $\frac{1}{2}$ —8.97
Berlin ...	M. to £	20.43	12.41—12.44	12.41—12.43
Vienna ...	Sch. to £	34.59	25 $\frac{1}{2}$ —27 $\frac{1}{2}$	25 $\frac{1}{2}$ —27 $\frac{1}{2}$
Budapest ...	Pen. to £	27.82	24 $\frac{7}{8}$ —25 $\frac{1}{8}$	24 $\frac{7}{8}$ —25 $\frac{1}{8}$
Prague ...	Kc. to £	164.25	142 $\frac{1}{2}$ —142 $\frac{7}{8}$	142 $\frac{1}{2}$ —142 $\frac{7}{8}$
Warsaw ...	Zloty to £	43.38	26 $\frac{1}{8}$ —26 $\frac{3}{8}$	26 $\frac{1}{8}$ —26 $\frac{3}{8}$
Riga ...	Lats. to £	25.22	24 $\frac{1}{4}$ —25 $\frac{1}{4}$	24 $\frac{1}{4}$ —25 $\frac{1}{4}$
Bucharest ...	Lei to £	813.60	665—690	665—690
Montevideo ...	Per peso	4s. 3d.	23 $\frac{3}{4}$ —24 $\frac{1}{4}$ d.	23 $\frac{3}{4}$ —24 $\frac{1}{4}$ d.
Stockholm ...	Kr. to £	18.16	19.35—19.45	19.35—19.45
Calcutta ...	Per rup.	1s. 6d.	1/6 $\frac{3}{4}$ —1/6 $\frac{5}{8}$	1/6 $\frac{3}{4}$ —1/6 $\frac{5}{8}$
Kobe ...	Per yen	24.58d.	1/3 $\frac{1}{2}$ —2/3 $\frac{1}{2}$	1/3 $\frac{1}{2}$ —2/3 $\frac{1}{2}$
Shanghai ...	Per tael	—	1/2—1/2 $\frac{1}{8}$	1/2—1/2 $\frac{1}{8}$
Buenos Aires	Pes. to £	11.45	17.90—18.30	17.01—17.06
Lima ...	Soles to £	17.38	20—21	20—21

¹ In the above list the New York quotations are telegraphic transfer rates. This means that debts are paid in either centre by bankers on receipt of instructions by cable from bankers in the other centre.

It will be noted in the above table that there are two methods of quotation: (1) a quotation in the currency of the foreign country; (2) a quotation in English currency. In the case of Kobe, for example, the quotation is given in pence per yen. Similarly the Calcutta and Montevideo rates are also in pence. These quotations therefore represent the amount of British currency which must be given in exchange for the standard coin of the other country, and they must be carefully distinguished from the other quotations which give the amount of foreign money, which will be received in exchange for the British pound sterling. It will also be observed that there is no par of exchange for Shanghai, for in this case the rate of exchange depends on the current market value of silver.

The Australian, New Zealand, and Union of South Africa exchange rates are quoted per 100 English pounds sterling, because these Dominions have as their standard coins gold pounds containing the same weight of pure gold as the English pound. Thus if we find the Australian rate quoted at £126 10s. this means that 100 English pounds are worth this amount in the Commonwealth of Australia on the date of the quotation.

It will be noted in addition that two daily quotations are given in the preceding list. In the case of New York, for instance, the first, $5\cdot00\frac{1}{4}$, represents the price which the buyers offer, and the second, $5\cdot01\frac{1}{8}$, represents the sellers' price. What, of course, "double-barrelled" rates of this nature mean is that the real trading price will be fixed at somewhere between these two quotations.

With reference to the various rates quoted it must be remembered that when a quotation is given in a foreign currency, such as the New York $5\cdot00\frac{1}{4}$ — $5\cdot01\frac{1}{8}$, and the quotations rise, then the rate of exchange is really falling and becoming more favourable to Great Britain. But when a quotation is given in the home currency, such as the 23 $\frac{1}{2}$ —

24½d. of Montevideo, a rise in the quotation means that the rate of exchange is also rising and therefore becoming more unfavourable to Great Britain.

Before the war the exchange rates never varied very much from the Mint par. In the case of Paris, for instance, such variations never exceeded a few centimes. The reason for this was that there were certain limits in the rise, or the fall, known as "gold" or "specie points," and if these were exceeded then debts were settled by payments of gold. The outgoing gold point is the rate of exchange at which gold is exported from a country for the purpose of debt settlement, and the incoming gold point is the rate at which gold comes in for a like purpose.

The gold points, therefore, depend on the cost of transmitting gold between the two countries concerned, which before the war was not an expensive item. The cost, for example, of sending gold from London to New York was only .024 cents per sovereign for insurance, commission and freight. Thus, when this was added to the Mint par (\$4.866 plus .024) the total of \$4.89 was the limit so far as the American debtor was concerned in the buying of bills of exchange. This was the incoming gold point, the point at which gold would be sent to Great Britain. Beyond this point an American debtor would not go when buying bills, because it would be cheaper to send gold.

Similarly, for every sovereign sent to New York a London remitter would receive \$4.866 — .024 cents, and the outgoing gold point would be \$4.842. Therefore if the London remitter could not obtain dollars payable in New York at a better rate than 4.842 per £1 it would be cheaper for him to send gold for the settlement of his debt.

This is the gold point theory. During the war as a result of the excessive use of paper money, and the prohibition of gold exports, gold points disappeared, but after the resumption of a free gold market in Great Britain, following the Gold

Standard Act of 1925, gold points again commenced to operate in connection with the London-New York exchange. Owing, however, to the increase in the charges for transport, the limits are not the same as the pre-war ones. The incoming gold point of the London-New York exchange was \$4.906 in the early part of 1928.

We must next consider the causes of the fluctuations of the rates of exchange, and in so doing we must remember that though there are various ways of settling international debts, the bill of exchange is the method most frequently used. "The basis of the business of foreign exchange," states Mr. Spalding,¹ "principally consists in the purchase and sale of foreign debts in the guise of bills of exchange."

Now a big demand, say in London, for bills on Paris means that British merchants are anxious to secure these bills for the purpose of paying for French goods which they have imported. An increased demand, therefore, shows that British imports from France have increased. The price of bills will rise, and for every pound sterling a merchant will obtain less francs than previously; the exchange rate will move against Great Britain, or, in other words, the quotation will go down.

But the British debtor of a Parisian creditor might, as has already been stated, obtain a draft on Paris from a bank, which, as a result of buying a number of bills on Paris, is in possession of a balance in the French capital. A draft of this nature sent directly to the creditor would settle the debt.

Both these methods mean that the British debtor has to buy either a bill of exchange or a banker's draft on Paris, therefore, the bill or draft will cost more than its face value. Large numbers of these transactions occur daily in the London Money Market. "Every day," remarks Mr. Walter,² "there are drafts moving about for different amounts, in

¹ *Foreign Exchange and Foreign Bills in Theory and Practice*, p. 5.

² *Foreign Exchange and Foreign Debts* (1926), p. 37.

different currencies, on different financial centres, and maturing at different dates."

It is thus obvious that the more goods Great Britain imports from France the bigger will be the demand for bills drawn on French traders or for bank drafts payable in France. An increased demand for such bills and drafts means an increase in their price; the British pound sterling in terms of francs will fall in value, and the French exchange will move against Great Britain.

On the other hand, an increased supply in London of bills drawn on Paris means that there has been an increase of British exports to France, and therefore the price of these bills will fall. The exporters will be able to get more francs for each pound sterling, and the rate of exchange will move in favour of Great Britain, that is to say, it will go up.

Thus, as the bulk of financial transactions between nations are conducted by means of bills drawn in connection with the exportation and importation of goods, which are termed trade or commercial bills,¹ and often referred to among traders as "white paper," the fluctuations of the rates of exchange are primarily due to fluctuations in exports and imports. If the exports of a country exceed the imports then the currency of that country will tend to have an increased value when compared with the currencies of other countries.

We must not, however, forget another factor which affects the rate of exchange between two countries, and that is the

¹ These must be distinguished from finance bills which do not relate to the exportation and importation of goods. Finance bills are defined by Mr. Spalding as "bills drawn by the banks and accepting houses of one country on those of another." (*Foreign Exchange and Foreign Bills*, p. 222.)

"Bank paper" is a term applied to bills accepted by banks and financial houses.

"House bills" are a type of finance bill. They are what Mr. Withers describes as "bills drawn by a firm or company on itself" (*Meaning of Money*, p. 53), and are used by branches of businesses when they draw on their headquarters.

actual conditions of the currencies of the countries concerned. If one of the currencies is greatly inflated, and has therefore fallen considerably in purchasing power, the exchange between the two countries will be seriously affected. Professor Cassel has recently given great attention to the variations in purchasing power of continental currencies. "Our valuation of a foreign currency in terms of our own money," he remarks,¹ "depends on the relative purchasing power of the two currencies in the respective countries."

"It seems safe to say," writes Mr. Walter,² "that inflation will depreciate the exchange value of a currency to at least the extent to which it raises prices." Professor Cassel states that when the currencies of two countries, X and Y, are inflated, a new parity may be calculated by comparing the amount of inflation in each country, assuming, of course, that the inflated currency of the one country will decrease in value in terms of the other currency.

How this comparison is made may be thus illustrated. X's money has, let us say, been inflated by 600 per cent. and Y's by 300 per cent. Therefore the new exchange rate, or what Professor Cassel terms the purchasing power parity of X's currency in terms of Y's, will be one half of the old rate. This new parity would thus replace the old Mint par of exchange between X and Y; the various daily quotations would always tend towards the new parity. The purchasing power parity is thus obtained by comparing prices in the two countries concerned, and it varies with the changes in price levels. The Mint par of exchange, on the other hand, never varies because it is based on the value of the gold content of the standard coins.

It is, however, necessary to remember that if the paper currency of a country is increased on a gold basis, and all the new notes are immediately convertible, then the

¹ *Money and Foreign Exchange after 1914* (1922), pp. 138-9.

² *Foreign Exchange and Foreign Debts*, p. 147.

exchanges will not be affected as regards this particular country. But if the increase in the volume of currency is due to the issue of inconvertible paper money then the exchanges will soon begin to be affected. As the purchasing power of inconvertible paper money declines in the country of issue so, also, does its exchange value decline.

It was the enormous increase in the inconvertible paper money of certain countries, together with the cessation of the free movement of gold from country to country, that caused such chaos in the European exchanges during the war and the years immediately following. "This depreciation of exchanges," remarks Sir Sydney Chapman,¹ "was due in the main to the excessive issue of paper money. But it was accentuated by the fact that a number of countries had their credit severely shaken, and were not in a position to furnish sufficient exports to pay for their most requisite imports or meet their foreign obligations."

As an illustration of this depreciation we may take the case of the German mark and the absolute collapse of its external purchasing power. The mark-sterling Mint par of exchange is, as we have seen, 20.43. When the treaty of peace was signed on June 28, 1919, the mark was quoted at about 80 in London. On November 30, 1921, the quotations were 940-1050; on December 31, 1921, 768-774; on June 30, 1922, 1435-1475; and, by the middle of August 1922, the figures had exceeded 4,000. The highest figure reached in 1922 was 39,500 on November 7. In 1923 there was a complete collapse, and the rate of exchange between London and Berlin was quoted in billions of marks to the pound.

Yet another factor which may influence the exchange rates is a big loan operation carried out by one country in the money market of another. If, for example, Portugal raises a loan in London, the immediate effects will be to make the rates of exchange move against London and in favour of Lisbon

¹ *Outlines of Political Economy*, p. 256.

because there will be a smaller demand for bills on London. But, in the long run, the rates will move in favour of London because, as the interest on the loan is paid by Portugal, there will be an increased demand for sterling bills.

It will now be apparent why in a commercial country like Great Britain, the raising of the Bank rate is of such importance in connection with the foreign exchange.

A rise in the Bank rate, in the minimum rate at which the Bank of England discounts bills and lends money, means that bills of exchange become more expensive to sell, and, as a result, the number of bills drawn on British merchants and financial houses will get less. Thus, if sterling bills decrease in number their price also increases, and the exchanges will then move in Britain's favour, in other words, the value of sterling will go up.

Furthermore, a rise in the Bank rate will attract gold from overseas. The investors of other countries and British merchants with balances abroad will hasten to transfer their money to Britain in order to obtain the higher rate of interest, while the foreign creditors of British traders, who have been paid in London, will tend to leave their money on deposit in a British bank and thus secure the additional interest.

The exchanges are, therefore, made to move in Britain's favour by raising the British rate. "When the bank rate is high," writes Sir Sydney Chapman,¹ "borrowing is discouraged by the heavy cost of borrowing; and, when less accommodation is sought from banks, there is less money to circulate, and prices in the country consequently tend to fall. When home prices fall, the country becomes a better market to buy in, but a worse market to sell in; consequently, exports are stimulated and imports are checked."

Finally, it must be remembered that London plays a very important part in the financing of international trade by means of what is termed the bill on London, and that such a

¹ *Outlines of Political Economy*, p. 258.

bill is drawn though the goods concerned do not enter England.

The function of the bill on London will be better realised with the help of an illustration, which will also show why the wealthy London accepting houses are of such importance in the trade of nations.

Let us suppose that a Brazilian coffee planter is anxious to sell a large quantity of coffee berries to a Lisbon merchant. If, however, the Portuguese importer is not known to the exporter it would not be wise for the Brazilian to ship the berries to Lisbon and then draw a bill of exchange on the importer. A method of payment must therefore be arranged which will satisfy both parties, and this is usually done by means of a London accepting house.

For a certain commission the accepting house guarantees, on behalf of the Lisbon merchant, the amount due to the exporter, the commission being paid by the importer, who, in addition, supplies the accepting house with certain securities. In brief, the accepting house lends its credit for a consideration, by accepting bills drawn on themselves by the Brazilian exporter.

The acceptance of a British financial house is regarded by the world's traders as the hall mark of security, as the finest guarantee that the bill will be met when it matures. The Brazilian exporter, therefore, does not hesitate to draw a bill of exchange on such an institution, that is to say, he draws what is called a bill on London, while the accepting house not only gets a commission from the Lisbon importer, but also secures possession of the shipping documents relating to the coffee berries.

The shipping documents will, of course, ultimately reach the Lisbon importer. If the accepting house has had many transactions of a similar nature with this particular importer, and found him prompt and meticulous in the conduct of his affairs, these documents will be sent to him at once, because, he in turn, will, before the bill matures, forward to the accepting

house a draft on a London banker in settlement of his account. On the other hand, the accepting house may send the shipping documents to a Lisbon bank together with a bill of exchange for the amount due drawn on the Lisbon importer, who accepts the bill, which then remains in the Lisbon bank until it matures.

The bill on London drawn by the Brazilian coffee planter may therefore result in the Portuguese importer buying a draft on London in order to settle with the accepting house, or in the accepting house drawing a bill on the Portuguese importer.

It is thus quite evident why the bill, or draft, on London is of such outstanding importance in international trade, and why London as a monetary centre is supreme among the world's money markets. The bill on London is immediately taken as payment for commodities in any part of the world; in every market it is regarded as the highest form of international currency. It is, as Mr. Withers so lucidly states,¹ "the real cash of international commerce and finance, because money in the real sense of the word, gold or its equivalent, is only to be had, always and without question, and to any amount, in London."

SUMMARY OF CHAPTER XIX.

The Settlement of International Debts.—International debts may be settled in five ways—

- (1) By bills of exchange.
- (2) By gold.
- (3) By bank drafts in a foreign currency (i.e. in the creditor's currency).
- (4) By drafts in the home currency (i.e. the debtor's currency).
- (5) By interest coupons payable in a foreign country.
- (6) By the debtor himself drawing on a balance in a foreign bank.

¹ *The Meaning of Money*, p. 91.

The Bill of Exchange Once More.—Bills of exchange are of two kinds, (1) inland, (2) foreign. The legal definition of a bill of exchange has already been given in Chapter XVI., *supra*. It is an instrument by means of which a creditor (the maker or drawer) instructs a debtor (the drawee, termed an acceptor when he accepts the bill) to pay a sum of money to the maker or another person, the person to whom the bill is to be paid being termed the payee.

A bill drawn "at sight" (a "sight draft") must be paid as soon as it is presented for acceptance. If a bill commences with such a phrase as "Ninety days after sight . . . pay . . ." it means that the bill must be paid 90 days after it is "sighted," i.e. presented for acceptance.

A seller of a bill must write his name on the back of the bill. This is termed an indorsement "in blank." A special indorsement makes the bill payable to "X or order."

A Typical Transaction in Foreign Bills of Exchange.—Suppose X an English merchant draws a bill on Y a French importer. After Y has accepted it the bill may be—

- (1) Immediately discounted in France.
- (2) Sold to a broker, and if the broker in turn sold it to an English bank, then the bank would send it to their French agents and thus be in a position to draw on a French balance.
- (3) Handed by X to his bank with authority to collect the sum specified, and credit his account with the same.

How Currencies are Compared.—A comparison of currencies is based on the weight and fineness of the gold contained in the standard gold coins of the countries concerned. The rate at which the standard coin of one country is convertible into that of another is termed the Mint par of exchange. Thus the London-New York or dollar-sterling Mint par of exchange is 4.8665.

There can be no Mint par of exchange between a country with a standard gold coin and a country with a standard silver coin. In this case the rate of exchange depends on the market price of silver.

If two countries possess paper currencies with nominal gold units, then the Mint par between these countries can be calculated by finding the number of units of paper money that are equivalent to the gold units in each country.

The Daily List of Exchange Rates.—Two quotations are given—a buyer's and a seller's price. On March 23, 1933, for example, the New York rates quoted in London were 3.41½ — 3.42½ dollars to the

pound. Usually the quotations are given in this way in the foreign currency, but sometimes they are given in the home currency, *e.g.* London-Kobe. on the same date, 1s. 3d. — 1s. 3½d. When the standard gold coins of two countries are equivalent in content then the quotations are given as premiums or discounts, *e.g.* the London-Australia rate quoted at £126 10s. means that £100 of English money is worth £126 10s. in Australia.

If the rates are quoted in the foreign currency a rise is favourable to the home country, if quoted in the home currency a rise is unfavourable.

The Gold Point Theory.—Before the war there were certain limits to the rise and fall of the exchange rates. These limits are termed "gold" or "specie" points, and they depend on the cost of transmitting gold between the two countries concerned. Thus, when in pre-war days the cost of sending gold from London to New York was only .024 cents per sovereign, the incoming gold point would be 4.89 and the outgoing 4.842. A Londoner would remit gold in order to settle an American debt if he could not obtain, by means of bills or drafts, dollars in New York at a better rate than 4.824, while an American under similar conditions would remit gold when the rate of exchange was 4.89.

The war upset this practice, but after the resumption of the Gold Standard by Great Britain in 1925 "gold" points again made their appearance.

Why the Rates of Exchange Fluctuate.—A big demand in London for bills of exchange on Paris means that the price of these bills will rise, and as a result the French exchange will move against Britain.

A big supply in London of bills on Paris means that the price of these bills will fall, and as a result the exchange will move in favour of Britain.

A demand in London for bills on Paris shows that British merchants are anxious to obtain these bills for the purpose of paying for French goods which they have imported.

An increased supply in London of bills on Paris shows that British exports to France have increased.

Therefore variations in the demand for, and supply of, bills depend on variations in exports and imports. An increase in imports tends to make the exchanges unfavourable to a country, while an increase in exports has an opposite effect.

Another factor which affects the rate of exchange between two countries is the condition of the respective currencies. By comparing the purchasing power of the two currencies we estimate what is termed purchasing power parity which varies with changes in price levels.

The inflation of the currency of one country will affect the exchanges. The collapse of the mark after the war is a striking illustration.

Yet another factor which may influence the exchange rates is a big

loan raised by one country in the money market of another. A Portuguese loan, for example, raised in London will in the first instance make the rates of exchange move against London and in favour of Lisbon. But in the long run the opposite effect will result.

The Bank Rate and Exchanges.—A rise in the bank rate means that bills of exchange will become more expensive to sell. Therefore bills drawn on British houses will decrease in number; their price will increase; and the exchanges will move in Britain's favour. In addition a rise in the bank rate attracts gold from overseas.

The Bill on London.—The bill on London is an important instrument in international trade by means of which a foreign trader can pay another trader for goods received. This is done through a London accepting house which, for a commission, accepts bills drawn on the house by foreign traders. Thus if a Brazilian exporter sells coffee to a Portuguese importer and the latter arranges with a London accepting house to accept bills drawn on this house for the coffee he has received, then the Brazilian draws what is termed a bill on London. Such a bill could easily be discounted anywhere.

CHAPTER XX.

TAXATION.

"Taxes are a portion of private wealth, exacted from individuals by the State for the purpose of meeting the expenditure essential to carrying out the functions of government."—Armitage-Smith, *Principles and Methods of Taxation*.

Taxation is one of the economic functions of government. "A tax," writes Professor Bastable,¹ "is a compulsory contribution of the wealth of a person, or body of persons, for the services of the public powers." Taxes may be direct or indirect, a classification which is based on the burden, the "incidence," or, as Professor Cannan would say, the "effects" of taxation. The burden of indirect taxes, such as those on commodities like sugar, tea, or matches, is passed on or "shifted" by the person on which it is levied to another person; it is added to the price, and therefore the consumer has to pay the tax. A direct tax is not passed on, but is paid by the person upon whom it is levied as in the income tax. Indirect taxation is therefore the usual method of extracting taxes from persons with small incomes.

We must, however, distinguish between local and national taxes. Local taxes or rates vary according to the expenditure of the local authorities. The rates, for example, in a provincial city like Chester are not the same as the rates in a Metropolitan

¹ *Public Finance* (third ed., 1903), p. 263.

borough like Islington. The amount of the rate levied is fixed by the local authority, therefore it might quite easily happen that a poor district pays a higher rate than a wealthy district. National taxes, on the other hand, are uniform throughout the country.

Then, again, rates are often levied in order that the local authority may render some beneficial service to the ratepayer, such as the provision of water, a public park, or a public library. The amount of the rate demanded from the ratepayer is fixed in accordance with the amount of the rent of his house or business premises. Furthermore, the revenue derived from local taxation is augmented by contributions, termed grants-in-aid, from the proceeds of national taxation. These grants are given to local authorities in order to enable them to carry out work of national importance, such as education and road construction.

Such are the main features of local taxation, which need not detain us further. The remainder of this chapter will therefore be devoted to national taxation; to national revenue, expenditure, and debt; and to the methods of reducing a nation's debt.

Taxes may be proportional or progressive. A proportional tax is levied at a uniform rate, and under this method an income receiver of £5,000 would be taxed at the same rate as the possessor of an income of £500, the £5,000 a year man paying more simply because his income is more. Under progressive or graduated taxation, however, the £5,000 a year man would have either the whole or part of his income taxed at a higher rate than the rate applied to the income of the £500 a year man. Thus a graduated tax is an attempt to produce equality of sacrifice among tax-payers.

This leads to a consideration of what are called the "canons" or maxims of taxation. Adam Smith recognised four of these which are known as the canons of equality, certainty, convenience, and economy. By certainty he meant

that the amount of the tax and the manner and time of payment should all be made clear in advance to the taxpayer; by convenience that a tax should be levied at the time and in the manner in which it would be most convenient for the taxpayer to pay, and that the process of production should be interfered with as little as possible; and by economy that taxation should "take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."¹ Smith advocated a system of taxation which would not in any way reduce the efficiency of the "agents" of production, a "well-ordered" system, which Dr. Armitage-Smith has described as one that "should satisfy certain fundamental tests—the principles of justice, productiveness, equity, economy, and simplicity."²

Smith's canon of equality or equity has been much discussed by economists. "The subjects," it states,³ "of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the state." But how are we to secure equity in taxation? How are we to measure the ability to pay?

It is obvious that we cannot regard the size of the income as an indication of the amount of tax to be paid. This is clearly illustrated in the cases of a married and a single man, each obtaining, say, a salary of £900 a year. To ask each to pay equal amounts as taxation would not be fair to the married man. In fact, it is not possible, owing to the varying circumstances of the taxpayer, to secure equality of sacrifice by means of the income tax. Sacrifice cannot be measured. "The real test of ability to pay," declares Dr. Armitage-Smith,⁴

¹ *Wealth of Nations* (Everyman's Library ed.), Vol. II., p. 308.

² *Principles and Methods of Taxation* (eighth ed., 1921), p. 33.

³ *Wealth of Nations*, Vol. II., p. 307.

⁴ *Principles and Methods of Taxation*, p. 66.

"is capacity to spend, and of this there can be no adequate measure." Nor could we secure more equality by raising the indirect taxes such as those on tea, sugar, and tobacco.

The graduation of the British income tax is an attempt to make the sacrifices of direct taxpayers more equal. All persons who pay this tax pay a certain standard rate (4s. 6d. in the £ in 1935-6),¹ while those with an income exceeding a certain sum (£2,000 in 1935-6) have also to pay an excess rate, that is, an addition to the standard rate, known as the sur-tax, which is gradually increased as the income increases. Thus in 1935-6 the sur-tax on "earned" income of over £2,500 and not exceeding £3,000 per annum was 1s. 3d. in the £, while from £10,000 to £15,000 it was 5s. 6d.²

"Earned" income must be carefully distinguished from "unearned" or, as it is now termed, "investment" income. The former includes salaries, wages, fees, pensions, superannuation allowances, deferred pay, income from business, and even income from property, if, of course, it is part of a man's regular wage or salary. "Investment" income includes the income from investments in property and in stocks, the interest on bank deposits, and the profits of limited companies. This differentiation was first introduced in Great Britain in the Budget of 1907.

In Great Britain direct taxes bring in much more revenue than indirect taxes. There are only two classes of British indirect taxes, the customs and the excise, while the direct taxes include the income tax, the estate duties, the house duty, the land tax, and the excess profits duty. Even a most casual comparison of a British post-war Budget with a pre-war example will show the enormous increase during recent

¹ The British Income tax standard rate from 1918-19 to 1921-22 was 6s. in the £; from 1909-10 to 1913-14 it was 1s. 2d.

² The heavy nature of the sur-tax sliding-scale is shown by the following amounts payable, in addition to the ordinary income tax, in 1932-3: On an income of £2,500, £27 10s.; on £5,000, £336 17s. 6d.; on £10,000, £1,519 7s. 6d.; on £20,000, £4,681 17s. 6d.

years of the British burden of taxation. In 1913-14 the total tax revenue received in Great Britain and Ireland was £163,029,000; in 1936-7 it amounted to £755,729,000 for Great Britain and Northern Ireland.

In addition to the direct and indirect taxes the British Budget contains another great section of receipts which is known as the "non-tax" revenue. This is made up of receipts from the Post Office, Telegraph, and Telephone services, the Crown Lands, and sundry loans, together with a very big item termed "Miscellaneous Receipts." The total British non-tax revenue for 1936-7 was £41,570,000.

Budgets, of course, are national balance sheets. The British one is presented to Parliament in April each year by the Chancellor of the Exchequer on behalf of the Cabinet, which is responsible for its accuracy and for any changes that are made. The Chancellor states the various totals of the three great sources of revenue, the indirect taxes, the direct taxes, and the non-tax; shows how all this revenue has been expended; and gives the estimated revenue and expenditure for the ensuing year.

The expenditure is grouped under two big branches known as the "Consolidated Fund Services" and "the Supply Services." The latter branch includes the expenses of the army, the navy, and the civil service, expenditure which is voted annually by Parliament. The Consolidated Fund expenditure is a permanent charge on the revenue, which includes the National Debt services, such as interest and revenues, specially set aside for the Debts' reduction which are termed Sinking Funds; payments to local taxation accounts, which are grants made to local authorities for the purpose of lessening the burden of rates; the road fund; payments to the Exchequer of Northern Ireland; and "other Consolidated Fund services" in which are included the so-called Civil List, a name applied to an item of expenditure which relates chiefly to the expenses of the Royal Household.

We have now reached what to all nations is an economic problem of paramount importance, the burden of a national debt. It is strange, in view of the enormous size of the debts of certain countries as a result of the Great War, how few people could explain, with any degree of accuracy, what the term national, or public, debt actually covers. What, for example, is the significance of such statements as : " the public debt of France on July 1, 1920, amounted to 233,729,000,000 francs, of which over 200,000,000,000 francs is an increase due to the war," and " the debt of the Italian Treasury on October 31, 1920, amounted to 102,072,000,000 lire, of which over 88,000,000,000 lire is an increase due to the war " ? How do such colossal debts accumulate ? To whom are the people of the countries concerned indebted ? What attempts are made to reduce such burdens ?

It must first of all be explained that public debts are made up of internal and external loans. In the case of the Italian debt mentioned above, only about one-fifth of the total was obtained outside Italy by means of external loans. In new countries, on the other hand, the public debt may quite possibly be largely made up of external loans, such for example, as the debt of Australia. But in old countries like France, Italy, and Great Britain the greater part of the public debt is internal, that is to say, it is mostly due to the people of the country concerned.

In the second place we must distinguish between " funded " and " unfunded " debt. A funded debt is made up of loans upon which the State pays an annual interest, but does not undertake to pay back the principal on any specified date. " Debt," states Maitland,¹ " is funded when the indebted nation is not under any obligation to pay the principal of the debt, but is merely bound to pay the interest for ever, or until it chooses to pay the debt." Unfunded debt consists of short period loans repayable on, or before, a definite date. Such

¹ *The Constitutional History of England* (1908), p. 442.

temporary loans are usually repaid in a specified number of months or years.

In countries like France, Italy, and England, temporary loans for a specified number of months, usually three, six, or twelve, are largely raised by means of Treasury bills which, as we have seen, are issued at a little less than their face value to persons who are able to take them in fairly large numbers, and who tender the highest sums for them. The recent British War Loans are also examples of unfunded debt. They are loans due for payment after a number of years, the State promising to repay the principal sums on, or before, a certain date, *e.g.* the Five Per Cent War Loan, 1929-47. Two large parts of the pre-war British debt, known as Consols, and carrying interest at $2\frac{1}{2}$ and 4 per cent. are examples of funded debt, and in these cases the debt is really perpetual, for the Government is not under any obligation to repay at any fixed time.

The Italian and French debt totals just quoted show how National debts rapidly accumulate as the result of war. As an illustration of such rapid accumulation we may take the British National Debt, and briefly examine its origin and growth. This colossal debt originated just after the accession of William III. in three big loans, the Million Loan of 1693, the Million Lottery Loan of 1694, and the original capital of the Bank of England, which, as is well known, was a sum of £1,200,000 advanced to the Government at 8 per cent. These were the first acknowledged items of the British National Debt, though another big loan, obtained over twenty years before the first of the preceding loans, is, from a historical standpoint, the first item. This was the debt of over £1,300,000 which Charles II. borrowed from the goldsmith bankers of his day, a debt which was not acknowledged as part of the National Debt until 1701, when the Government decided to pay interest on half of it.

As a result of the heavy expenses of many wars the British

National Debt quickly grew. At the end of the American War of Independence in 1783 it stood at £283,000,000, and in 1816, the year after the battle of Waterloo, it was £846,000,000. By 1899 it had been gradually reduced to £627,562,000, but the South African War of 1899-1901 added £160,000,000, and the Great War of 1914-18 and its aftermath increased it from £651,000,000 in 1914 to £7,829,000,000 in 1920. It is, as we have seen, to a large extent an internal debt, that is to say, it is made up of public loans subscribed by the British people. So that if the reader has subscribed to one of the recent British War Loans, or if he holds even a single British National Savings Certificate, he is one of the persons to whom the British State owes part of its public debt. On March 31, 1937, the internal portion of the British National Debt amounted to £6,883,963,804, and the external to £1,032,563,090.

But whereas to-day the British National Debt is to a large extent in the hands of very many Englishmen, Scotsmen, Irishmen, and Welshmen, the position was quite different a hundred years ago. In the England of William IV. there was no income tax—it had already been abolished in 1815, and was not re-introduced until Peel's Budget of 1842—and the taxes then levied were chiefly indirect; the public debt was in the hands of the few.

Indeed, it is interesting to note how, in Britain during the last hundred years, the burden of taxation has gradually shifted from the shoulders of the indirect taxpayers to those of the direct. In 1841, for example, 73 per cent. of British tax revenue was paid indirectly; in 1927 less than 20 per cent. This is a remarkable change, and is due to the great decrease since 1842 in the taxation of commodities. In fact, a very great part—nearly half in 1936-7—of the British burden of taxation is carried at present by the payers of income tax who, in 1936-7, comprised only about one-eighteenth of the population.

We must, before leaving the question of the debts of nations, consider some of the methods employed for their reduction. A reference has been made to the Sinking Fund. This is the most important of the British methods. A sum is set apart in the annual Budget not only for payment of interest but also for repayment of principal. A method disscussed very much of late is that of a special tax on capital, the so-called capital levy. This, however, has not been tried in England. Another method, which was actually tried by Walpole in the early part of the eighteenth century, is the earmarking of certain specified taxes for the redemption of debt. Yet another is the English system of "terminable annuities." These annuities are paid by the Treasury for a certain number of years to those who, under this condition, agree to accept payment of their portion, i.e. capital and interest, of the National Debt.

This completes our survey of the principles of taxation, with particular reference to Great Britain and its National Debt. It is evident that our classification of income into rent, wages, profits, and interest covers all the various kinds of "earned" and "unearned" or "investment" income. Pensions and superannuation allowance, for example, are really of the nature of wages, for they are simply payments for services rendered—a kind of deferred pay. Wages, salaries, emoluments, fees, gratuities, rent, profits, interest, dividends, bonuses, brokerage, commission—it does not matter what terms are used to cover various degrees of meaning—all belong to one of the two big divisions of income: income from work or income from property.

SUMMARY OF CHAPTER XX.

The Classification of Taxes.—Taxes may be—

- (1) *Direct*, which are paid by the person on whom they are levied.
- (2) *Indirect*, which are passed on by the person on whom they are levied to another person or persons.

They may also be classified into—

(1) *Proportional*, which are levied at a uniform rate whatever the amount of the income.

(2) *Progressive*, or graduated, in which the rate is gradually increased as the income is increased.

Local taxation must be distinguished from national. The revenue from local taxation is augmented by "grants-in-aid" from national revenue.

The Canons of Taxation.—Adam Smith recognises the following four canons or maxims of taxation :—

(1) The canon of equality, or equity : Persons are expected to contribute to the upkeep of the state "in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the state."

(2) The canon of certainty : The time and manner of payment, and the amount to be paid should all be made clear to the contributor.

(3) The canon of convenience : That the tax should be levied at the time and in the manner in which it is most convenient for the contributor to pay.

(4) The canon of economy: Every tax should "take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."

The British Income Tax.—The British income tax is an attempt to make the sacrifices of direct taxpayers more equal. It is a graduated tax, and a distinction is made between—

(1) Earned income, such as wages, fees, pensions.

(2) Investment income, formerly termed "unearned" income, which includes income from investments in property and in stocks, the interest on bank deposits, and the profits of limited companies.

British Revenue and Expenditure.—The details of the revenue from taxes are given in the national balance sheets or Budgets. The British receipts are divided into—

(1) Tax revenue.

(2) Non-tax revenue, such as the receipts from the Post Office, Telegraph, and Telephone services, and the Crown Lands.

The British expenditure appears under two headings—

(1) Consolidated Fund Services.

(2) Supply Services.

Public Debts.—The debt of a nation is made up of internal loans, which are raised within the boundaries of a country, and external loans, which are obtained from outside services. In countries like France, Italy, and Great Britain, the greater part of the public debt is internal. A public debt may be—

(1) *Funded*, which is made up of loans on which the State pays an annual interest but does not undertake to pay back the principal on any specified date.

(2) *Unfunded*, which consists of short period loans repaid on or before a definite date.

The British National Debt.—The British National Debt originated in three loans: the Million Loan of 1693; the Million Lottery Loan of 1694; and the original capital of the Bank of England, a sum of £1,200,000 raised in 1694 and advanced to the Government at 8 per cent. In 1899 it amounted to £627,562,000, and in 1932 to £7,647,950,026.

Methods of Debt Reduction.—Various methods may be employed for reducing national debts such as—

(1) The Sinking Fund—a sum set apart in the Budget each year for payment of interest and repayment of principal.

(2) The Capital Levy—a special tax on capital.

(3) The earmarking of certain specified taxes for the redemption of debt.

(4) Terminable annuities.

APPENDIX I.

(To Supplement Chapter IV.).

A COST OF LIVING INDEX NUMBER.

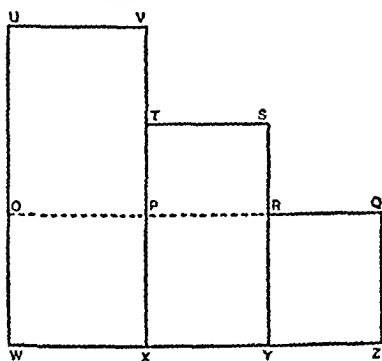
The following is a specimen of the food section of the Ministry of Labour Index Number of January 1938 which shows changes in the cost of living. It gives a percentage comparison of the level of retail prices on three dates. It is published monthly in the *Ministry of Labour Gazette*, and is preceded by a table of the actual prices of the commodities mentioned. The percentage indicates the increase or decrease (—) of prices. The index number is 45, i.e. the prices of the commodities were on February 1, 1938, 45 per cent. higher than their prices in July 1914. On January 1, 1931, the food index number was 38, and on January 1, 1932, 31.

	Average Percentage Increase or Decrease (—) on February 1, 1938, as compared with July 1914.			Corresponding General Average for Dec. 31, 1932.
	Large Towns (Populations over 50,000).	Small Towns and Villages.	General Average.	
	Per cent.	Per cent.	Per cent.	Per cent.
Beef, British—				
Ribs	46	46	46	46
Thin Flank ...	18	19	18	18
Beef, Chilled or Foreign—				
Ribs	32	35	34	34
Thin Flank ...	—	6	3	— 5
Mutton, British—				
Legs	54	58	56	55
Breast	23	25	24	24
Mutton, Foreign—				
Legs	55	50	52	52
Breast	— 1	— 7	— 3	— 4
Bacon (streaky) ...	— 37	— 37	— 37	— 37
Fish	116	94	105	100
Flour	50	51	52	53
Bread	64	62	63	63
Tea	43	47	45	45
Sugar (granulated)	30	22	26	26
Milk	95	103	99	99
Butter—				
Fresh	16	25	21	22
Salt	— 10	— 15	— 12	— 15
Cheese	27	29	28	28
Margarine	— 6	— 8	— 7	— 7
Eggs (fresh)	95	91	93	112
Potatoes	41	— 19	30	29
All above (Weighted Percentage Increase)	45	45	45	46

APPENDIX II.

(To Supplement Chapter X.)

DIAGRAM ILLUSTRATING THE ECONOMIC THEORY OF RENT.



Let us assume that WX , XY , and YZ are three equal areas of wheat-producing land receiving equal applications or "doses" of capital and labour, and that owing to variations in fertility WX produces $WXVU$; XY , $XYST$; and YZ , $YZQR$. The price of the produce of the area of least fertility (YZ) will just cover the outlay of the farmer of this area (the marginal farmer). But each of the farmers of the other two areas spent the same amount on cultivation as did the marginal farmer, and they have obtained surpluses ($OPVU$ and $PRST$), i.e. each has, through advantages of fertility, raised more produce than was needed to cover expenses. Each surplus is rent, and it goes to the person who owns the land.

APPENDIX III.

(To Supplement Chapter XVI.)

GREAT BRITAIN'S SUSPENSION OF THE GOLD STANDARD IN 1931.

At a Cabinet meeting held on Sunday, September 20, 1931, it was decided to suspend the gold standard, which had been operative in Great Britain since its resumption on April 29, 1925, and the following official announcement was made immediately after the meeting:

His Majesty's Government has decided, after consideration with the Bank of England, that it has become necessary to suspend for the time being the operation of Subsection 2 of Section 1 of the Gold Standard Act 1925 which requires the Bank to sell gold at a fixed price. A Bill for this purpose will be introduced immediately, and it is the intention of His Majesty's Government to ask Parliament to pass it in all its stages. In the meantime the Bank of England has been authorised to proceed accordingly in anticipation of the action of Parliament.

This official announcement also gave the following reasons for the suspension. From the middle of July to September 20, 1931, sums amounting to £200,000,000 had been withdrawn from London, and these withdrawals were partly met from gold and foreign money in the Bank of England, partly from a credit of £50,000,000 secured by the Bank from New York and Paris, and partly from the proceeds of French and American credits amounting to £80,000,000 obtained by the Government. In the week preceding September 20 these withdrawals had so rapidly increased that the Government was compelled to make the above decision. The gold holding in the Bank of England had dropped to £130,000,000, and the Cabinet came to the conclusion that it would be dangerous to allow this to be further reduced.

The Act known as the Gold Standard (Amendment) Act of 1931 duly became law on Monday, September 21. Subsection 2 of Section 1 of the Gold Standard Act of 1925 which it suspended states that "the Bank of England shall be bound to sell to any person who makes a demand in that behalf at the head office of the Bank of England, and pays the purchase price in any legal tender, gold bullion at the price of £3 17s. 10½d. per ounce troy of gold of the standard fineness prescribed for gold coin by the Coinage Act of 1870, but only in the form of bars containing approximately 400 ounces of fine gold."

Thus since the passing of the Gold Standard (Amendment) Act on September 21, 1931, the Bank of England is no longer bound to give gold for any of its notes, not even if the value of those presented for payment is equivalent to the value of 400 ounces of fine (i.e. pure) gold. This is what is meant by the suspension of the gold standard in this country in 1931.

The crisis was, as the official announcement of the Cabinet explained, caused by the rapid withdrawal of bank balances (chiefly foreign) from London. It is important, however, to note that when the Gold Standard (Amendment) Act was passed it did not in any way affect British banking firms. On Monday, September 21, the British banks opened for business at the usual time and carried on in the usual way. The Stock Exchange, however, was closed on the Monday, and the Bank rate was raised from 4½ to 6 per cent, the latter rate operating from that day.

APPENDIX IV.

(To Supplement Chapter XVII.).

COMPARATIVE STATISTICS ILLUSTRATING THE POSITION OF THE "BIG SIX" ENGLISH JOINT- STOCKS BANKS IN 1930, 1931 AND 1936.

Banks.	Year.	Capital. £	Reserve Fund. £	Deposits. £	Net Profits. £
Barclays ...	1930	15,858,217	10,250,000	339,388,361	1,821,207
	1931	"	"	325,850,461	1,794,825
	1936	"	"	429,538,416	1,894,361
Lloyds ...	1930	15,810,252	10,000,000	364,648,601	2,129,515
	1931	"	7,500,000	333,645,127	1,926,903
	1936	"	9,000,000	406,037,564	1,743,955
Martins ...	1930	4,160,042	2,900,000	78,579,378	793,551
	1931	"	"	75,944,034	703,154
	1936	"	3,300,000	93,495,906	769,988
Midland ...	1930	14,248,012	14,248,012	395,632,143	2,318,689
	1931	"	11,500,000	357,454,098	2,056,986
	1936	"	"	479,766,998	2,467,894
National Provincial	1930	9,479,416	9,479,416	292,205,567	1,930,845
	1931	"	8,000,000	261,503,042	1,747,008
	1936	"	"	320,898,299	1,770,173
Westminster	1930	9,320,157	9,320,157	288,821,828	1,821,887
	1931	"	7,500,000	270,337,324	1,601,822
	1936	"	9,320,157	364,308,831	1,731,954

Compiled from analyses of the annual Reports of these banks published in the *Banker's Magazine*, March and April 1933 and 1937.

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BIBLIOGRAPHY.

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There are also a number of excellent quarterly periodicals devoted to economics, such as the *Quarterly Journal of Economics* (Harvard), the *American Economic Review* (the official publication of the American Economic Association), the *Journal of Political Economy* (Chicago), *Economica* (London School of Economics), and the *Economic Journal* (the official publication of the Royal Economic Society).

For currency and banking questions the *Bankers' Magazine*, the *Banker*, and the *Journal of the Institute of Bankers* should be consulted.

Such periodicals as the *Fortnightly Review*, the *Quarterly Review*, the *English Review*, the *Contemporary Review*, and the *Nineteenth Century* frequently publish articles of great interest to the economist. Many of these journals are usually available in a good municipal library.

Government Reports and publications are, of course, indispensable. A great deal of valuable information will be found in the various publications of the League of Nations. Year

books such as *Whitaker's Almanack*, *Hazell's Annual*, the *Statesman's Year Book*, and the *Daily Mail Year Book*, are useful for reference.

In view of the voluminous nature of the literature of economics the following list, while including some of the best known of the earlier treatises, is chiefly confined to recent English and American books. For the guidance of the reader with a knowledge of French and German, a short list of important works in these languages is also added.

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